

EXECUTIVE SUMMARY

The Statewide Single Audit of the Commonwealth of Kentucky For the Year Ended June 30, 2001

BACKGROUND: The Single Audit Act of 1984, subsequent amendments, and corresponding regulations, require the auditing of financial statements and the compliance and internal controls applicable to federal moneys received by the Commonwealth.

EXPENDITURES: 46 state agencies expended federal awards in the following manner:

- \$4,920,901,924 in cash from 20 federal grantors
- \$ 533,668,566 in noncash grants (i.e., food stamps)

SUMMARY OF AUDITOR'S RESULTS:

Financial Statement Accounts

34 financial statement findings, 11 of which are material.

Federal Awards and Schedule of Expenditures of Federal Awards

23 federal award findings, two (2) of which are material.

GENERAL TOPICS OF REPORTABLE CONDITIONS:

- Inaccurate, incomplete transaction documentation
- Inadequate technology procedures, policies, and security
- Noncompliance with federal and state laws and regulations

<u>Agencies With Reportable Conditions:</u>	<u>Agencies With Noncompliances:</u>
Cabinet for Families and Children Finance and Administration Cabinet Governor's Office for Technology Cabinet for Health Services Labor Cabinet Personnel Cabinet Revenue Cabinet Office of the Kentucky State Treasurer Transportation Cabinet Cabinet for Workforce Development	Department of Agriculture Cabinet for Families and Children Finance and Administration Cabinet Labor Cabinet Department of Military Affairs Council on Postsecondary Education Cabinet for Workforce Development



EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

May 15, 2002

To the People of Kentucky
Honorable Paul E. Patton, Governor
T. Kevin Flanery, Secretary
Finance and Administration Cabinet

As Auditor of Public Accounts, I am pleased to transmit herewith our report of the Statewide Single Audit of the Commonwealth of Kentucky for the year ended June 30, 2001. This report contains our independent auditor's report on the Commonwealth's supplementary Schedule of Expenditures of Federal Awards and our reports on the Commonwealth's compliance with laws and regulations and on internal control over financial reporting and compliance. Accompanying this report is the Commonwealth's Comprehensive Annual Financial Report, which contains our independent auditor's report on the general-purpose financial statements of the Commonwealth issued December 21, 2001.

On behalf of the Division of Financial Audit of the Auditor of Public Account's Office, I wish to thank the employees of the Commonwealth for their cooperation during the course of our audit. Should you have any questions concerning this report, please contact Charlene Daniels, CPA, Director, Division of Financial Audit, or me.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ed Hatchett".

Edward B. Hatchett, Jr.
Auditor of Public Accounts



**REPORT OF THE STATEWIDE SINGLE AUDIT
OF THE
COMMONWEALTH OF KENTUCKY
FOR THE YEAR ENDED JUNE 30, 2001**

**EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS
www.kyauditor.net**

**144 CAPITOL ANNEX
FRANKFORT, KY 40601
TELE. (502) 564-5841
FAX (502) 564-2912**

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INTRODUCTION

**COMMONWEALTH OF KENTUCKY
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001**

Introduction

The Auditor of Public Accounts (APA), acting as principal auditor in conjunction with various certified public accounting firms, annually performs a statewide single audit of the Commonwealth of Kentucky. This audit allows the Commonwealth to comply with federal audit requirements as set forth in the Single Audit Act of 1984, as amended by Public Law 104-156, and the regulations contained in the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Using This Report

The reporting package includes the financial statements, Schedule of Expenditures of Federal Awards (SEFA), Summary Schedule of Prior Audit Findings, auditor's reports, and corrective action plans. For the year ended June 30, 2001, the Single Audit Report is presented in two volumes: the Comprehensive Annual Financial Report (CAFR) and the Single Audit Report.

The CAFR, dated December 21, 2001, which contains the general-purpose financial statements and the auditor's report thereon, has been issued under separate cover. The CAFR contains an Introductory Section, which discusses the component units of the Commonwealth, the economic conditions and outlook for the Commonwealth, the major initiatives authorized by the state legislature, and financial analysis of revenues and expenditures on a budgetary and a Generally Accepted Accounting Principles (GAAP) basis. Debt administration, cash management, investment and collateral policy, risk management, capital projects fund, proprietary funds, pension trust fund, university and college funds, and general fixed asset policies are also discussed in the Introductory Section of the CAFR. The Introductory Section of the CAFR is followed by the Commonwealth's financial statements, notes to the financial statements, and a statistical section.

The Single Audit Report, the second volume, contains the auditor's reports on compliance and internal control over financial reporting, on compliance and internal control over compliance with requirements applicable to major federal programs, and on the Schedule of Expenditures of Federal Awards. The Single Audit Report also contains the Schedule of Expenditures of Federal Awards, Schedule of Findings and Questioned Costs (including summary of auditor's results, financial statement findings, and federal award findings and questioned costs), and the Summary Schedule of Prior Audit Findings. The corrective action plans for current year findings are reported in the Schedule of Findings and Questioned Costs.

**COMMONWEALTH OF KENTUCKY
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Schedule of Expenditures of Federal Awards

The Schedule of Expenditures of Federal Awards is organized by federal grantor. The Catalog of Federal Domestic Assistance (CFDA) numbers and program names are listed under the federal grantor administering the program. The state agencies expending the federal funds are listed beside each CFDA number. The Notes to the Schedule of Expenditures of Federal Awards provide more detailed information on certain aspects of the expenditures, such as the amount given to subrecipients.

Since not all state agencies use the Management Administrative Reporting System (MARS) Subsystems for Projects, the APA requested all state agencies (excluding state universities) to prepare worksheets of federal financial assistance, both cash and non-cash. The source of these worksheets included MARS, agency accounting systems, agency manual records, etc. The agencies were also asked to reconcile the worksheets to MARS and to federal grantor reports. These worksheets were compiled into the accompanying Schedule of Expenditures of Federal Awards.

Schedule of Findings and Questioned Costs

The Schedule of Findings and Questioned Costs consists of three (3) sections:

- Summary of Auditor's Results,
- Financial Statement Findings, and
- Federal Award Findings and Questioned Costs.

The audit finding number and classification (as reportable or material) are provided as part of the audit opinion summary. Major programs audited are listed on the summary of auditor's results. The financial statement findings list the audit findings related to the financial statements (required to be reported in accordance with *Government Auditing Standards*). The federal award findings and questioned costs lists all findings related to federal awards. Generally, the state agency, CFDA number and program, federal agency, pass-through agency, and the compliance area to which the finding relates are presented. In both reports, reportable conditions and reportable instances of noncompliance are presented first, then material weaknesses and material instances of noncompliance.

The finding number consists of the last two numbers of the fiscal year (FY) (01 for current year findings), the state agency abbreviation (e.g., CFC for Cabinet for Families and Children), the state agency level report finding number (from reports issued to individual state agencies audited by the APA or a Certified Public Accounting (CPA) Firm) and the sequential numbering of all statewide single audit findings (1 through 57 for FY 01).

**COMMONWEALTH OF KENTUCKY
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Summary Schedule of Prior Audit Findings

Audit findings reported in the Schedule of Findings and Questioned Costs for the fiscal year ended June 30, 2000, as well as any previous findings which have not been resolved, are reported in the Summary Schedule of Prior Audit Findings for the fiscal year ended June 30, 2001. If the APA determines the agency's Summary Schedule of Prior Audit Findings materially misrepresents the status of any prior audit finding, a new audit finding is issued and reported in the Schedule of Findings and Questioned Costs.

The Summary Schedule of Prior Audit Findings is organized based on whether the prior year finding was reportable or material. The findings of each classification (reportable and material) are categorized as (1) fully corrected, (2) not corrected or partially corrected, (3) corrective action taken differs significantly from corrective action previously reported, or (4) finding no longer valid or does not warrant further action.

Audit Approach

Our audit was conducted in accordance with the Single Audit Act Amendments of 1996, OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, *Government Auditing Standards* (also referred to as the Yellow Book), and auditing standards generally accepted in the United States of America. The scope of the statewide single audit for the year ended June 30, 2001 included:

- An audit of the general-purpose financial statements and required supplementary schedules in accordance with auditing standards generally accepted in the United States of America;
- An audit of the supplementary Schedule of Expenditures of Federal Awards (excluding state universities, as discussed below) in accordance with auditing standards generally accepted in the United States of America;
- An audit of the internal control applicable to the Commonwealth's organizational units and administrative bodies, to the extent necessary to consider and test the internal accounting and administrative control systems as required; and

**COMMONWEALTH OF KENTUCKY
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Audit Approach (Continued)

- A selection and testing of transactions and records relating to each major program to obtain reasonable assurance that the Commonwealth administers its major programs in compliance with laws and regulations for which noncompliance could have a material effect on the allowability of program expenditures or on the general-purpose financial statements of the Commonwealth.

The APA conducted the audit of internal controls, focusing on the following objectives:

- Considering the internal control in order to determine auditing procedures on the general-purpose financial statements of the Commonwealth.
- Determining if the Commonwealth has internal controls to provide reasonable assurance that it is managing the major programs in compliance with applicable laws and regulations.

Status of State Universities

The Single Audit Act Amendments permit the single audit to cover the entire operations of the entity or include a series of audits covering departments, agencies, or other organizational units expending federal awards. The agencies audited as part of the statewide single audit of the Commonwealth are listed in Appendix 1. The Commonwealth has elected to exclude state universities from the statewide single audit, except as part of the audit of the general-purpose financial statements. Thus, state universities are not included in the accompanying Schedule of Expenditures of Federal Awards and reports on internal control and compliance. It should be noted, however, that state universities are still required to have audits performed in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Contacting the Commonwealth

If additional copies of the statewide single audit of the Commonwealth are required, please contact Mona Logsdon, Open Records Administrator, with the APA's office at (502) 564-5841 or mlogsdon@kyauditor.net. If copies of the CAFR for the fiscal year ended June 30, 2001 are required, please contact T. Kevin Flanery, Finance and Administration Cabinet Secretary, at (502) 564-4240.

**COMMONWEALTH OF KENTUCKY
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

List Of Abbreviations/Acronyms Used In This Report

ACH	Account Clearing House
ADDs	Area Development Districts
AGR	Department of Agriculture
AFR	Annual Financial Report
AICPA	American Institute of Certified Public Accountants
APA	Auditor of Public Accounts
C1	Cash Receipt Document
CAFR	Comprehensive Annual Financial Report
CAMRA	Complete Asset Management Reporting and Accounting System
CCDF	Child Care and Development Fund
CCMMF	Child Care Mandatory and Matching Funds of the Child Care and Development Fund
CDP	Custom Data Processing, Inc.
CFC	Cabinet for Families and Children
CFR	Code of Federal Regulations
CFDA	Catalog of Federal Domestic Assistance
CHS	Cabinet for Health Services
CIO	Chief Information Officer
CISO	Chief Information Security Officer
CMHC	Community Mental Health Center
CMIA	Cash Management Improvement Act of 1990
CMS	Center for Medicare/Medicaid Services
Commonwealth	Commonwealth of Kentucky
CPA	Certified Public Accountant
CPE	Council on Postsecondary Education
CPMS	Claim Payment and Management System
CR	Cash Receipt Document
CSE	Child Support Enforcement
CWD	Cabinet for Workforce Development
DCBS	Department for Community Based Services
DEC	Digital Equipment Corporation (now part of Compaq)
DMS	Department of Medicaid Services
DOL	U.S. Department of Labor
DPH	Department for Public Health
DRP	Dispute Resolution Program
DSI	Department of Social Insurance
DTR	Department for Training and ReEmployment
EBT	Electronic Benefit Transfer

**COMMONWEALTH OF KENTUCKY
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

List Of Abbreviations/Acronyms Used In This Report (Continued)

ED	Exposure Draft
EDGE	The software system at eFunds Corporation used to transfer electronic benefit authorization for the food stamps program
EFT	Electronic Funds Transfer
ETA	Employment and Training Administration
FAC	Finance and Administration Cabinet
FDAC	Federal Domestic Assistance Catalog Division
FEMA	Federal Emergency Management Agency
FEP	Front End Processor
FMRB	Financial Management and Reporting Branch
FNS	Food and Nutrition Services
FSR	Financial Status Reports
FTP	File Transfer Protocol
FUTA	Federal Unemployment Tax Administration
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	United States General Accounting Office
GASB	Governmental Accounting Standards Board
GOT	Governor's Office for Technology
GSC	Governmental Service Center
IRS	Internal Revenue Service
IT	Information Technology
JCL	Job Control Language
JQSR	Job Training Partnership Act Quarterly Status Report
JTPA	Job Training Partnership Act
KAMES	Kentucky Automated Management and Eligibility System
KASES	Kentucky Automated Support and Enforcement System
KCCMS	Kentucky Child Care Management System
KDE	Kentucky Department of Education
KET	Kentucky Educational Television
KEWES	Kentucky Electronic Workplace for Employment Services
KEES	Kentucky Educational Excellence Scholarship
KHEAA	Kentucky Higher Education Assistance Authority
KRC	Kentucky Revenue Cabinet
KRS	Kentucky Revised Statutes
KSFB	Kentucky State Fair Board
KST	Office of the Kentucky State Treasurer
KY	Kentucky

**COMMONWEALTH OF KENTUCKY
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

List Of Abbreviations/Acronyms Used In This Report (Continued)

KyEM	Kentucky Division of Emergency Management
LAB	Labor Cabinet
LAN	Local Area Network
LIHEAP	Low-Income Home Assistance Program
LWIA	Local Workforce Investment Areas
MA	Department of Military Affairs
MAP	Medicaid Assistance Program
MARS	Management Administrative Reporting System
MFE	Modernized Front End
MIL	Department of Military Affairs
MRDB	Management Reporting Database
NA	Not Applicable
NCGA	National Council on Governmental Accounting
NMB	Network Management Branch
NT	New Technology
OAG	Office of the Attorney General
OFM	Office of Financial Management
OFMEA	Office of Financial Management and Economic Analysis
OIG	Office of Inspector General
OMB	Office of Management and Budget
OTS	Office of Technology Services
PBU	Project Budget Unit
PC	Personal Computer
PDS	Prevention Data Set
PERS	Personnel Cabinet
PY	Prior Year
Personnel	Personnel Cabinet
RACF	Resource Access Control Facility
RCW	Record of Control Weakness
REV	Kentucky Revenue Cabinet
Revenue	Kentucky Revenue Cabinet
RPC	Regional Prevention Center
SAR	System Access Request
SAS	Statements on Auditing Standards
SDA	Service Delivery Area
SEC	Securities and Exchange Commission
SEFA	Schedule of Expenditures of Federal Awards
SLCM	Systems Life Cycle Manual

**COMMONWEALTH OF KENTUCKY
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

List Of Abbreviations/Acronyms Used In This Report (Continued)

SMI	Supplementary Medical Insurance
SY	State Fiscal Year
TAD	Turn Around Document
TANF	Temporary Assistance for Needy Families
TC	Transportation Cabinet
Treasury	Office of the Kentucky State Treasurer
TSO	Time-Sharing Option
TWIST	The Workers Information System
UI	Unemployment Insurance
Unisys	The corporation under contract with the Cabinet for Health Services to process Medicaid Claims
UPPS	Uniform Personnel and Payroll System
U.S.	United States
USDA	United States Department of Agriculture
USSC	United States Supreme Court
VAX	Virtual Address extension (a DEC VAX is a line of mid-range computers)
VSIS	Vital Statistics Information System
WIA	Workforce Investment Act
WIC	Women, Infants, and Children Program
WtW	Welfare-to-Work

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Agriculture</u>				
Direct Programs:				
10.025	Plant and Animal Disease, Pest Control, and Animal Care	Department of Agriculture	\$ 50,900	\$
10.064	Forestry Incentives Program	Natural Resources and Environmental Protection Cabinet	2,400	
10.069	Conservation Reserve Program (Note 14)	Natural Resources and Environmental Protection Cabinet		
10.153	Market News (Note 14)	Department of Agriculture		
10.156	Federal-State Marketing Improvement Program (Note 14)	Department of Agriculture		
10.162	Inspection Grading and Standardization	Department of Agriculture	297	
10.163	Market Protection and Promotion	Department of Agriculture	53,012	
10.550	Food Distribution (Note 2) (Note 9) (Note 13)	Department of Agriculture		15,697,806
10.551	Food Stamps (Note 2) (Note 4) (Note 13)	Cabinet for Families and Children		344,117,592
10.553	School Breakfast Program (Note 2) (Note 9)	Department of Education	29,412,350	
		Department of Juvenile Justice		
10.555	National School Lunch Program (Note 2) (Note 9)	Department of Education	90,879,266	
		Department of Juvenile Justice		
10.556	Special Milk Program for Children (Note 2) (Note 9)	Department of Education	87,732	
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children (Note 2) (Note 9)	Cabinet for Health Services	81,331,341	
10.558	Child and Adult Care Food Program (Note 2) (Note 9)	Department of Education	23,727,070	
10.559	Summer Food Service Program for Children (Note 2) (Note 9)	Department of Education	3,065,808	
10.560	State Administrative Expenses for Child Nutrition	Department of Agriculture	1,840,213	
		Department of Education		
10.561	State Administrative Matching Grants for Food Stamp Program (Note 2) (Note 9)	Office of the Attorney General	27,065,228	
		Cabinet for Families and Children		
		Cabinet for Health Services		
10.565	Commodity Supplemental Food Program (Note 4) (Note 13)	Department of Agriculture	269,814	1,111,913
10.568	Emergency Food Assistance Program (Administrative Costs)	Department of Agriculture	817,017	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Agriculture (Continued)</u>				
Direct Programs (Continued):				
10.569	Emergency Food Assistance Program (Food Commodities) (Note 13)	Department of Agriculture		5,159,418
10.570	Nutrition Program for the Elderly (Commodities) (Note 9)	Cabinet for Health Services	1,722,933	
10.572	WIC Farmers' Market Nutrition Program (FMNP)	Department of Agriculture	107,553	
10.652	Forestry Research	Natural Resources and Environmental Protection Cabinet	303,968	
10.664	Cooperative Forestry Assistance (Note 9) (Note 13)	Natural Resources and Environmental Protection Cabinet	1,851,996	3,552,638
10.766	Community Facilities Loans and Grants (Note 2) (Note 3e) (Note 13)	Kentucky Housing Corporation		50,144,498
10.769	Rural Business Enterprise Grants	Department of Agriculture	4,466	
		Department for Local Government		
10.771	Rural Cooperative Development Grants (Note 14)	Department of Agriculture		
10.901	Resource Conservation and Development	Natural Resources and Environmental Protection Cabinet	2,268	
10.912	Environmental Quality Incentives Program	Natural Resources and Environmental Protection Cabinet	12,418	
10.913	Farmland Protection Program	Department of Agriculture	252,230	
10.914	Wildlife Habitat Incentive Program (Note 13)	Department of Fish and Wildlife Resources	62,213	21,000
NA	Rural Rehabilitation Student Loan Program (Note 3a)	Department of Agriculture	106,417	
Total U.S. Department of Agriculture			\$ 263,028,910	\$ 419,804,865

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies		
CFDA #		Expending Federal	Expenditures	
Program Title		Awards	Cash	Noncash
<hr/>				
<u>U.S. Department of Commerce</u>				
Direct Programs:				
11.305	Economic Development - State and Local Economic Development Planning (Note 9)	Department for Local Government	\$ 51,710	
11.307	Economic Adjustment Assistance (Note 3b)	Department for Local Government	37	
11.450	Integrated Flood Observing and Warning System (IFLOWS)	Department of Military Affairs	91,285	
11.550	Public Telecommunications Facilities - Planning and Construction	Kentucky Educational Television	69,937	
 Passed Through From Personal Responsibility in a Desirable Environment:				
11.469	Congressionally Indentified Construction Projects Pass Through Grantor's # - NA	Natural Resources and Environmental Protection Cabinet	160,641	
			<hr/>	
Total U.S. Department of Commerce			\$ 373,610	
<hr/>				
<u>U.S. Department of Defense</u>				
Direct Programs:				
12.002	Procurement Technical Assistance for Business Firms	Department of Community Development	\$ 114,831	
12.113	State Memorandum of Agreement Program for the Reimbursement of Technical Services	Natural Resources and Environmental Protection Cabinet	438,576	
NA	Chemical Demilitarization and Remediation Activity for Hazardous Waste Activities at Chemical Demilitarization Facilities (Note 9)	Natural Resources and Environmental Protection Cabinet	32,969	
NA	Monitoring of Wildlife Project	Department of Fish and Wildlife Resources	34,450	
NA	Teacher and Teacher's Aide Placement Assistance Program	Department of Education Education Professional Standards Board	63,798	
			<hr/>	
Total U.S. Department of Defense			\$ 684,624	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Housing and Urban Development</u>				
Direct Programs:				
14.117	Mortgage Insurance-Homes (Note 2) (Note 3e) (Note 13)	Kentucky Housing Corporation	\$	\$ 92,092,533
14.169	Housing Counseling Assistance Program	Kentucky Housing Corporation	65,883	
14.182	Lower Income Housing Assistance Program - Section 8 New Construction/Substantial Rehabilitation (Note 2)	Kentucky Housing Corporation	68,023,673	
14.185	Homeownership and Opportunity for People Everywhere (Note 9)	Kentucky Housing Corporation	24,886	
14.227	Community Development Block Grants/Special Purpose Grants/Technical Assistance Program (Note 14)	Department for Local Government		
14.228	Community Development Block Grants/State's Program (Note 2) (Note 9)	Department for Local Government	39,530,487	
14.230	Rental Housing Rehabilitation (Note 14)	Department for Local Government		
14.231	Emergency Shelter Grants Program (Note 9)	Kentucky Housing Corporation	1,467,873	
		Department for Local Government		
14.235	Supportive Housing Program (Note 9)	Kentucky Housing Corporation	3,061,926	
14.238	Shelter Plus Care (Note 9)	Kentucky Housing Corporation	292,680	
14.239	HOME Investment Partnerships Program (Note 2) (Note 9)	Kentucky Housing Corporation	15,796,929	
14.241	Housing Opportunities for Persons with AIDS (Note 9)	Kentucky Housing Corporation	1,353,682	
14.401	Fair Housing Assistance Program - State and Local	Kentucky Commission on Human Rights	149,369	
14.408	Fair Housing Initiatives and Administrative Enforcement Initiative Program	Kentucky Commission on Human Rights	9,001	
14.855	Section 8 Rental Voucher Program	Kentucky Housing Corporation	589,956	
14.856	Lower Income Housing Assistance Program - Section 8 Moderate Rehabilitation (Note 2)	Kentucky Housing Corporation	825,397	
14.857	Section 8 Rental Certificate Program	Kentucky Housing Corporation	2,451,520	
14.871	Section 8 Housing Choice Vouchers	Kentucky Housing Corporation	11,209,174	
NA	HUD Disaster Recovery Initiative (Note 9)	Department for Local Government	836,270	
Total U.S. Department of Housing and Urban Development			\$ 145,688,706	\$ 92,092,533

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies		
CFDA #		Expending Federal	Expenditures	
Program Title		Awards	Cash	Noncash
<u>U.S. Department of the Interior</u>				
Direct Programs:				
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining (Note 9) (Note 13)	Natural Resources and Environmental Protection Cabinet	\$ 12,360,926	\$ 18,490
15.252	Abandoned Mine Land Reclamation (AMLR) Program (Note 9) (Note 13)	Natural Resources and Environmental Protection Cabinet	14,707,152	26,600
15.605	Sport Fish Restoration	Department of Fish and Wildlife Resources	3,092,971	
15.608	Fish and Wildlife Management Assistance	Natural Resources and Environmental Protection Cabinet	14,111	
15.808	U.S. Geological Survey-Research and Data Acquisition (Note 13)	Natural Resources and Environmental Protection Cabinet		284,151
15.611	Wildlife Restoration (Note 11)	Department of Fish and Wildlife Resources	2,394,579	
15.615	Cooperative Endangered Species Conservation Fund (Note 9)	Department of Fish and Wildlife Resources	140,985	
15.616	Clean Vessel Act	Natural Resources and Environmental Protection Cabinet		
15.617	Wildlife Conservation and Appreciation	Department of Fish and Wildlife Resources	29,022	
15.618	Administrative Grants for Federal Aid in Sport Fish and Wildlife Restoration (Note 14)	Department of Fish and Wildlife Resources	67,150	
15.623	North American Wetlands Conservation Fund	Department of Fish and Wildlife Resources		
15.810	National Cooperative Geologic Mapping Program	Department of Fish and Wildlife Resources	954,720	
15.904	Historic Preservation Fund Grants-In-Aid (Note 9)	Department of Fish and Wildlife Resources	98,313	
		Kentucky Heritage Council	762,639	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of the Interior (Continued)</u>				
Direct Programs (Continued):				
15.916	Outdoor Recreation - Acquisition, Development and Planning (Note 7) (Note 9)	Department for Local Government	91,286	
NA	Wolf Creek National Fish Hatchery	Department of Fish and Wildlife Resources	3,217	
NA	National Fish and Wildlife Foundation- Restoration of Elk Habitat in Kentucky	Department of Fish and Wildlife Resources	554	
Total U.S. Department of the Interior			\$ 34,717,625	\$ 329,241

U.S. Department of Justice

Direct Programs:

16.523 Juvenile Accountability Incentive Block Grants (Note 9)	Administrative Office of the Courts Department of Juvenile Justice Department of Public Advocacy Unified Prosecutorial System	\$ 4,456,063	
16.540 Juvenile Justice and Delinquency Prevention - Allocation to States (Note 9)	Administrative Office of the Courts Department of Juvenile Justice	783,855	
16.542 National Institute for Juvenile Justice and Delinquency Prevention (Note 9)	Department of Juvenile Justice	628,538	
16.548 Title V - Delinquency Prevention Program (Note 9)	Department of Juvenile Justice	482,744	
16.549 Part E - State Challenge Activities (Note 9)	Department of Juvenile Justice	103,743	
16.550 State Justice Statistics Program for Statistical Analysis Centers	Office of the Attorney General Justice Cabinet - Office of the Secretary	10,393	
16.554 National Criminal History Improvement Program (NCHIP)	Department of Corrections Justice Cabinet - Office of the Secretary Department of State Police	728,631	
16.560 National Institute of Justice Research, Evaluation, and Development Project Grants (Note 14)	Department of State Police		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Justice (Continued)</u>				
Direct Programs (Continued):				
16.575	Crime Victim Assistance (Note 9)	Justice Cabinet - Office of the Secretary Unified Prosecutorial System	4,948,429	
16.576	Crime Victim Compensation	Crime Victims Compensation Board	59,566	
16.579	Byrne Formula Grant Program (Note 9)	Administrative Office of the Courts Office of the Attorney General Department of Corrections Cabinet for Health Services Justice Cabinet - Office of the Secretary Department of Juvenile Justice Department of Public Advocacy Department of State Police Unified Prosecutorial System	6,625,514	
16.580	Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	Administrative Office of the Courts Department of Corrections Department of State Police	3,158,257	
16.582	Crime Victim Assistance/Discretionary Grants (Note 14)	Office of the Attorney General		
16.585	Drug Court Discretionary Grant Program	Administrative Office of the Courts	407,670	
16.586	Violent Offender Incarceration and Truth in Sentencing Incentive Grants	Department of Corrections Justice Cabinet - Office of the Secretary Department of Juvenile Justice	638,753	
16.588	Violence Against Women Formula Grants (Note 9)	Office of the Attorney General Office of the Governor Justice Cabinet - Office of the Secretary Unified Prosecutorial System	2,007,536	
16.589	Rural Domestic Violence and Child Victimization Enforcement Grant Program (Note 9)	Justice Cabinet - Office of the Secretary	108,489	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Justice (Continued)</u>				
Direct Programs (Continued):				
16.590	Grants to Encourage Arrest Policies and Enforcement of Protection Orders (Note 9)	Justice Cabinet - Office of the Secretary	39,103	
16.592	Local Law Enforcement Block Grants Program (Note 9)	Administrative Office of the Courts Department of Criminal Justice Training Justice Cabinet - Office of the Secretary Department of Juvenile Justice Department of State Police	625,380	
16.593	Residential Substance Abuse Treatment for State Prisoners	Department of Corrections Justice Cabinet - Office of the Secretary	761,424	
16.598	State Identification Systems Grant Program	Justice Cabinet - Office of the Secretary Department of State Police	163,156	
16.606	State Criminal Alien Assistance Program (Note 14)	Department of Corrections		
16.607	Bulletproof Vest Partnership Program (Note 9)	Department of Fish and Wildlife Resources Justice Cabinet - Office of the Secretary Department of State Police	68,316	
16.710	Public Safety Partnership and Community Policing Grants	Department of Corrections Justice Cabinet - Office of the Secretary Department of State Police	284,529	
16.712	Police Corps	Department of Criminal Justice Training	622,528	
16.727	Enforcing Underage Drinking Laws Program (Note 9)	Department of Alcoholic Beverage Control Department of State Police	454,512	
NA	Drug Enforcement Administration	Department of State Police	1,603,019	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<hr/>				
<u>U.S. Department of Justice (Continued)</u>				
Passed Through From Eastern Kentucky University:				
16.710	Public Safety Partnership and Community Policing Grants Pass Through Grantor's # - Various	Department of Criminal Justice Training	2,887	
			<hr/>	
Total U.S. Department of Justice			\$ 29,773,035	
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<u>U.S. Department of Labor</u>				
Direct Programs:				
17.002	Labor Force Statistics	Cabinet for Workforce Development	\$ 753,939	
17.005	Compensation and Working Conditions	Labor Cabinet	122,820	
17.203	Labor Certification for Alien Workers	Cabinet for Workforce Development	337,593	
17.207	Employment Service	Cabinet for Workforce Development	10,641,122	
17.225	Unemployment Insurance (Note 2) (Note 5) (Note 9)	Cabinet for Workforce Development	379,762,912	
17.235	Senior Community Service Employment Program (Note 9)	Cabinet for Health Services	1,601,861	
17.245	Trade Adjustment Assistance - Workers	Cabinet for Workforce Development	9,160,937	
17.246	Employment and Training Assistance - Dislocated Workers (Note 9)	Cabinet for Workforce Development	281,309	
17.249	Employment Services and Job Training Pilots - Demonstrations and Research (Note 9)	Cabinet for Workforce Development	313,776	
17.250	Job Training Partnership Act (Note 9)	Department of Education	1,052,203	
		Cabinet for Workforce Development		
17.253	Welfare-to-Work Grants to States and Localities (Note 9)	Cabinet for Families and Children	8,077,388	
		Cabinet for Health Services		
		Cabinet for Workforce Development		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Labor (Continued)</u>				
Direct Programs (Continued):				
17.255	Workforce Investment Act (Note 2) (Note 9)	Cabinet for Workforce Development	32,073,487	
17.503	Occupational Safety and Health - State Program	Labor Cabinet	3,259,386	
17.504	Consultation Agreements	Labor Cabinet	19,891	
17.600	Mine Health and Safety Grants	Department of Mines and Minerals	624,800	
17.801	Disabled Veterans' Outreach Program (DVOP)	Cabinet for Workforce Development	677,325	
17.804	Local Veterans' Employment Representative Program	Cabinet for Workforce Development	726,649	
NA	National Occupational Information Coordinating Committee	Cabinet for Workforce Development	3,304	
Total U.S. Department of Labor			\$ 449,490,702	

U.S. Department of Transportation
Direct Programs:

20.005 Boating Safety Financial Assistance	Department of Fish and Wildlife Resources	\$ 649,838	
20.106 Airport Improvement Program	Transportation Cabinet	9,000	
20.205 Highway Planning and Construction (Note 2) (Note 6)	Transportation Cabinet	511,179,709	
20.218 National Motor Carrier Safety (Note 9)	Transportation Cabinet	3,952,420	
20.219 Recreational Trails Program (Note 7) (Note 9)	Department for Local Government Department of Parks	434,433	
20.505 Federal Transit - Metropolitan Planning Grants (Note 9)	Transportation Cabinet	328,197	
20.507 Federal Transit - Formula Grants (Note 9)	Transportation Cabinet	2,432,977	
20.509 Formula Grants for Other Than Urbanized Areas (Note 9)	Transportation Cabinet	5,424,884	
20.513 Capital Assistance Program for Elderly Persons and Persons with Disabilities (Note 9)	Transportation Cabinet	1,438,659	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Transportation (Continued)</u>				
Direct Programs (Continued):				
20.600	State and Community Highway Safety (Note 9)	Department of Criminal Justice Training Department of State Police Transportation Cabinet	3,310,734	
20.604	Safety Incentive Grants for Use of Seatbelts	Department of State Police	311,287	
20.700	Pipeline Safety	Public Service Commission	272,698	
20.703	Interagency Hazardous Materials Public Sector Training and Planning Grants	Department of Military Affairs	138,313	
NA	Joint Federal/State Motor Fuel Tax Compliance Project (Note 14)	Kentucky Revenue Cabinet		
Total U.S. Department of Transportation			\$ 529,883,149	
<u>U.S. Appalachian Regional Commission</u>				
Direct Programs:				
23.001	Appalachian Regional Development	Department of Education	\$ 63,314	
23.002	Appalachian Area Development (Note 9)	Department for Local Government	39,873	
23.005	Appalachian Housing Project Planning Loan, Technical Assistance Grant and Site Development and Off-Site Improvement Grant - State Appalachian Housing Programs	Kentucky Housing Corporation Department for Local Government	726,629	
23.011	Appalachian State Research, Technical Assistance, and Demonstration Projects (Note 9)	Department of Business Development Department for Local Government	60,938	
NA	Regional Tourism Initiative	Department of Travel	467	
Total U.S. Appalachian Regional Commission			\$ 891,221	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies		
CFDA #		Expending Federal	Expenditures	
Program Title		Awards	Cash	Noncash
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<u>U.S. Equal Employment Opportunity Commission</u>				
Direct Program:				
30.002	Employment Discrimination - State and Local Fair Employment Practices Agency Contracts	Kentucky Commission on Human Rights	\$ 97,393	
			<hr/>	
Total U.S. Equal Employment Opportunity Commission			\$ 97,393	
<hr/> <hr/>				
<u>U.S. General Services Administration</u>				
Direct Program:				
39.003	Donation of Federal Surplus Personal Property (Note 13)	Finance and Administration Cabinet		\$ 945,851
			<hr/>	
Total U.S. General Services Administration				\$ 945,851
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<u>U.S. National Foundation on the Arts and the Humanities</u>				
Direct Programs:				
45.015	Promotion of the Arts - Folk and Traditional Arts (Note 14)	Kentucky Historical Society		
45.025	Promotion of the Arts - Partnership Agreements (Note 9)	Kentucky Arts Council	\$ 576,373	
45.026	Promotion of the Arts - Leadership Initiatives	Kentucky Center for the Arts		
		Kentucky Arts Council	65,500	
		Kentucky Historical Society		
45.129	Promotion of the Humanities - Federal/State Partnership	Kentucky Historical Society	14,445	
45.310	State Library Program (Note 9)	Department for Libraries and Archives	2,017,252	
			<hr/>	
Total U.S. National Foundation on the Arts and the Humanities			\$ 2,673,570	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
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<u>U.S. Department of Veterans Affairs</u>				
Direct Program:				
64.114	Veterans Housing-Guaranteed and Insured Loans (Note 2) (Note 3e) (Note 13)	Kentucky Housing Corporation		\$ 8,155,705
			<hr/>	
Total U.S. Department of Veterans Affairs				\$ 8,155,705
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<u>U.S. Environmental Protection Agency</u>				
Direct Programs:				
66.001	Air Pollution Control Program Support	Natural Resources and Environmental Protection Cabinet	\$ 1,597,856	\$
66.032	State Indoor Radon Grants (Note 9)	Cabinet for Health Services	261,458	
66.419	Water Pollution Control - State and Interstate Program Support	Natural Resources and Environmental Protection Cabinet	1,209,408	
66.432	State Public Water System Supervision	Natural Resources and Environmental Protection Cabinet	819,721	
66.438	Construction Management Assistance	Natural Resources and Environmental Protection Cabinet	284,977	
66.454	Water Quality Management Planning (Note 9)	Natural Resources and Environmental Protection Cabinet	24,963	
66.458	Capitalization Grants for State Revolving Funds (Note 2) (Note 3d)	Kentucky Infrastructure Authority	8,600,211	
66.460	Nonpoint Source Implementation Grants (Note 13)	Natural Resources and Environmental Protection Cabinet	2,464,465	22,590
66.461	Wetlands Grants (Note 9)	Department of Fish and Wildlife Resources	44,891	
		Natural Resources and Environmental Protection Cabinet		
66.463	Water Quality Cooperative Agreements (Note 9)	Natural Resources and Environmental Protection Cabinet	201,270	
66.467	Wastewater Operator Training Grant Program (Technical Assistance)	Natural Resources and Environmental Protection Cabinet	32,054	
66.468	Capitalization Grants for Drinking Water State Revolving Fund (Note 2) (Note 3d)	Kentucky Infrastructure Authority	6,774,653	
		Natural Resources and Environmental Protection Cabinet		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies		
CFDA #		Expending Federal	Expenditures	
Program Title		Awards	Cash	Noncash
<u>U.S. Environmental Protection Agency (Continued)</u>				
Direct Programs (Continued):				
66.470	Hardship Grants Program for Rural Communities (Note 14)	Natural Resources and Environmental Protection Cabinet		
66.606	Surveys, Studies, Investigations and Special Purpose Grants (Note 9) (Note 13)	Cabinet for Health Services	349,066	67,965
66.700	Consolidated Pesticide Enforcement Cooperative Agreements	Natural Resources and Environmental Protection Cabinet	509,857	
66.701	Toxic Substances Compliance Monitoring Cooperative Agreements (Note 9)	Department of Agriculture		
66.707	TSCA Title IV State Lead Grants - Certification of Lead-Based Paint Professionals (Note 9)	Natural Resources and Environmental Protection Cabinet	94,661	
66.708	Pollution Prevention Grants Program (Note 9)	Cabinet for Health Services	366,734	
66.801	Hazardous Waste Management State Program Support	Natural Resources and Environmental Protection Cabinet	65,769	
66.802	Superfund State Site - Specific Cooperative Agreements	Natural Resources and Environmental Protection Cabinet	1,632,271	
66.804	State and Tribal Underground Storage Tanks Program	Natural Resources and Environmental Protection Cabinet	171,688	
66.805	Leaking Underground Storage Tank Trust Fund Program	Natural Resources and Environmental Protection Cabinet	246,061	
66.809	Superfund State Core Program Cooperative Agreements (Note 14)	Natural Resources and Environmental Protection Cabinet	1,221,179	
Total U.S. Environmental Protection Agency			\$ 26,973,213	\$ 90,555

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor CFDA # Program Title	State Agencies Expending Federal Awards	Expenditures	
		Cash	Noncash
<u>U.S. Department of Energy</u>			
Direct Programs:			
81.039	National Energy Information Center	Natural Resources and Environmental Protection Cabinet	\$ 6,111
81.041	State Energy Program (Note 9)	Natural Resources and Environmental Protection Cabinet Transportation Cabinet	724,097
81.042	Weatherization Assistance for Low-Income Persons (Note 9)	Cabinet for Families and Children Cabinet for Health Services	3,230,861
81.086	Conservation Research and Development	Natural Resources and Environmental Protection Cabinet	58,152
81.089	Fossil Energy Research and Development (Note 14)	Department of Mines and Minerals	
81.119	State Energy Program Special Projects (Note 9)	Natural Resources and Environmental Protection Cabinet	18,799
81.502	Paducah Gaseous Diffusion Plant Environmental Monitoring and Oversight (Note 9)	Cabinet for Health Services Natural Resources and Environmental Protection Cabinet	1,636,781
Passed Through From State of North Carolina Department of Commerce:			
81.041	State Energy Program (Note 14)	Natural Resources and Environmental Protection Cabinet	
	Pass Through Grantor's # - NA		
Total U.S. Department of Energy		\$	5,674,801

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Federal Emergency Management Agency</u>				
Direct Programs:				
83.011	Hazardous Materials Training Program for Implementation of the Superfund Amendment and Reauthorization Act (SARA) of 1986 (Note 14)	Department of Military Affairs	\$	
83.012	Hazardous Materials Assistance Program	Department of Military Affairs	1,810	
83.105	Community Assistance Program - State Support Services Element (CAP-SSSE)	Department of Military Affairs Natural Resources and Environmental Protection Cabinet	107,010	
83.505	State Disaster Preparedness Grants (Note 14)	Department of Military Affairs		
83.534	Emergency Management-State and Local Assistance	Department of Military Affairs	4,269	
83.536	Flood Mitigation Assistance	Department of Military Affairs	21,891	
83.539	Crisis Counseling	Department of Military Affairs	28,709	
83.543	Individual and Family Grants	Department of Military Affairs	95,490	
83.544	Public Assistance Grants (Note 9)	Department of Military Affairs Transportation Cabinet	3,542,782	
83.548	Hazard Mitigation Grant (Note 9)	Department of Military Affairs	2,363,931	
83.549	Chemical Stockpile Emergency Preparedness Program (Note 9)	Cabinet for Health Services Department of Military Affairs	4,465,123	
83.550	National Dam Safety Program	Natural Resources and Environmental Protection Cabinet	30,659	
83.552	Emergency Management Performance Grants (Note 9)	Department of Military Affairs	2,274,433	
Total U.S. Federal Emergency Management Agency			\$ 12,936,107	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor CFDA # Program Title	State Agencies Expending Federal Awards	Expenditures	
		Cash	Noncash
<u>U.S. Department of Education</u>			
Direct Programs:			
84.002	Adult Education - State Grant Program (Note 9)	Kentucky Educational Television Cabinet for Workforce Development	\$ 5,998,433
84.010	Title I Grants to Local Educational Agencies (Note 2) (Note 9)	Department of Education	127,815,102
84.011	Migrant Education - Basic State Grant Program (Note 9)	Department of Education	10,018,062
84.013	Title I Program for Neglected and Delinquent Children (Note 9)	Department of Corrections Department of Education Department of Juvenile Justice	636,983
84.023	Special Education - Innovation and Development (Note 9)	Department of Education	94,885
84.025	Services for Children with Deaf-Blindness (Note 14)	Department of Education	
84.027	Special Education - Grants to States (Note 2) (Note 9)	Department of Education	59,922,124
84.032	Federal Family Education Loans (Note 2) (Note 3c)	Kentucky Higher Education Assistance Authority Kentucky Higher Education Student Loan Corporation	50,706,598
84.048	Vocational Education - Basic Grants to States (Note 2) (Note 9)	Department of Education Cabinet for Workforce Development	19,113,221
84.069	Leveraging Educational Assistance Partnership (Note 2)	Kentucky Higher Education Assistance Authority	516,502
84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States (Note 2) (Note 9)	Department of Education Cabinet for Workforce Development	40,615,369
84.128	Rehabilitation Services-Service Projects (Note 9)	Cabinet for Workforce Development	77,678
84.161	Rehabilitation Services - Client Assistance Program	Cabinet for Workforce Development	128,292
84.162	Immigrant Education (Note 9)	Department of Education	572,644

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Education (Continued)</u>				
Direct Programs (Continued):				
84.169	Independent Living - State Grants (Note 9)	Cabinet for Workforce Development	341,250	
84.173	Special Education - Preschool Grants (Note 2) (Note 9)	Department of Education	8,964,427	
84.177	Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind (Note 9)	Cabinet for Workforce Development	444,614	
84.181	Special Education - Grants for Infants and Families with Disabilities (Note 9)	Department of Education	4,472,877	
84.185	Byrd Honors Scholarships (Note 9)	Cabinet for Health Services		
		Department of Education	540,389	
84.186	Safe and Drug-Free Schools and Communities - State Grants (Note 9)	Department of Education	6,564,998	
		Office of the Governor		
		Cabinet for Health Services		
		Department of State Police		
84.187	Supported Employment Services for Individuals with Severe Disabilities (Note 9)	Cabinet for Workforce Development	574,329	
84.194	Bilingual Education Support Services (Note 9)	Department of Education	15,569	
84.196	Education for Homeless Children and Youth (Note 9)	Department of Education	508,058	
84.213	Even Start - State Educational Agencies (Note 9)	Department of Education	2,291,709	
84.215	Fund for the Improvement of Education (Note 9)	Department of Education	135,350	
84.216	Capital Expenses (Note 9)	Department of Education	356,075	
84.224	Assistive Technology (Note 9)	Department of Public Advocacy	388,504	
		Cabinet for Workforce Development		
84.240	Program of Protection and Advocacy of Individual Rights	Department of Public Advocacy	89,927	
84.243	Tech-Prep Education (Note 9)	Department of Education	1,224,327	
		Cabinet for Workforce Development		
84.265	Rehabilitation Training - State Vocational Rehabilitation Unit In-Service Training	Cabinet for Workforce Development	118,162	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Education (Continued)</u>				
Direct Programs (Continued):				
84.276	Goals 2000 - State and Local Education Systemic Improvement Grants (Note 9)	Kentucky Center for the Arts	6,099,027	
84.278	School-to-Work Implementation Grant (Note 9)	Department of Education Cabinet for Workforce Development	107,861	
84.281	Eisenhower Professional Development State Grants (Note 9)	Department of Education Council on Postsecondary Education	4,490,641	
84.293	Foreign Language Assistance (Note 9)	Department of Education	51,048	
84.298	Innovative Education Program Strategies (Note 9)	Kentucky Center for the Arts Department of Education	4,321,530	
84.314	Even Start - Statewide Family Literacy Program	Department of Education	4,256	
84.318	Technology Literacy Challenge Fund Grants (Note 9)	Department of Education	5,521,872	
84.323	Special Education - State Program Improvement Grants for Children with Disabilities (Note 9)	Department of Education Cabinet for Health Services	1,001,262	
84.326	Special Education - Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities (Note 9)	Department of Education	105,762	
84.327	Special Education - Technology and Media Services for Individuals with Disabilities (Note 9)	Department of Education	221,060	
84.330	Advanced Placement Incentive Program (Note 9)	Department of Education	204,202	
84.331	Grants to States for Incarcerated Youth Offenders	Department of Corrections	53,647	
84.332	Comprehensive School Reform Demonstration (Note 9)	Department of Education	2,168,048	
84.334	Gaining Early Awareness and Readiness for Undergraduate Programs (Note 9)	Council on Postsecondary Education	133,549	
84.338	Reading Excellence (Note 9)	Department of Education	2,746,837	
84.340	Class Size Reduction (Note 9)	Department of Education	13,690,487	
84.346	Occupational and Employment Information State Grants	Cabinet for Workforce Development	30,790	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Education (Continued)</u>				
Passed Through From Public Broadcasting Service:				
84.203	Star Schools (Note 2)	Kentucky Educational Television	319,719	
	Pass Through Grantor's # - NA			
Total U.S. Department of Education			\$ 384,518,056	
<u>U.S. Department of Health and Human Services</u>				
Direct Programs:				
93.041	Special Programs for the Aging - Title VII, Chapter 3 - Programs for Prevention of Elder Abuse, Neglect, and Exploitation (Note 9)	Cabinet for Health Services	\$ 65,702	\$
93.042	Special Programs for the Aging - Title VII, Chapter 2 - Long Term Care Ombudsman Services for Older Individuals (Note 9)	Cabinet for Health Services	123,712	
93.043	Special Programs for the Aging - Title III, Part F - Disease Prevention and Health Promotion Services (Note 9)	Cabinet for Health Services	201,017	
93.044	Special Programs for the Aging - Title III, Part B - Grants for Supportive Services and Senior Centers (Note 9)	Cabinet for Health Services	4,888,856	
93.045	Special Programs for the Aging - Title III, Part C - Nutrition Services (Note 9)	Cabinet for Health Services	7,308,172	
93.046	Special Programs for the Aging - Title III, Part D - In-Home Services for Frail Older Individuals (Note 9)	Cabinet for Health Services	12,988	
93.048	Special Programs for the Aging - Title IV - Training, Research and Discretionary Projects and Programs (Note 9)	Cabinet for Health Services	15,563	
93.052	Nation Family Caregiver Support Program	Cabinet for Health Services	69,043	
93.110	Maternal and Child Health Federal Consolidated Programs (Note 9)	Commission for Children with Special Health Care Needs Cabinet for Health Services	489,476	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Health and Human Services (Continued)</u>				
Direct Programs (Continued):				
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs (Note 9) (Note 13)	Cabinet for Health Services	1,020,062	82,418
93.119	Grants for Technical Assistance Activities Related to the Block Grant for Community Mental Health Services - Technical Assistance Centers for Evaluation	Cabinet for Health Services	45,863	
93.130	Primary Care Services - Resource Coordination and Development - Primary Care Offices (Note 9)	Cabinet for Health Services	71,147	
93.136	Injury Prevention and Control Research and State and Community Based Programs (Note 9)	Cabinet for Health Services	396,989	
93.138	Protection and Advocacy for Individuals with Mental Illness	Department of Public Advocacy	597,801	
93.150	Projects for Assistance in Transition from Homelessness (PATH) (Note 9)	Cabinet for Health Services	300,000	
93.217	Family Planning - Services (Note 9)	Cabinet for Health Services	4,200,021	
93.230	Consolidated Knowledge Development and Application (KD&A) Program (Note 9)	Cabinet for Health Services	4,755,648	
93.234	Traumatic Brain Injury - State Demonstration Grant Program (Note 9)	Cabinet for Health Services	10,316	
93.235	Abstinence Education (Note 9)	Cabinet for Health Services	498,535	
93.238	Cooperative Agreements for State Treatment Outcomes and Performance Pilot Studies Enhancement (Note 9)	Cabinet for Health Services	498,817	
93.241	State Rural Hospital Flexibility Program	Cabinet for Health Services	170,000	
93.251	Universal Newborn Hearing Screening	Commission for Children with Special Health Care Needs	87,407	
93.262	Occupational Safety and Health Research Grants (Note 9)	Cabinet for Health Services	97,820	
93.268	Immunization Grants (Note 9) (Note 13)	Cabinet for Health Services	2,102,185	11,577,662
93.283	Centers for Disease Control and Prevention - Investigations and Technical Assistance (Note 9)	Commission for Children with Special Health Care Needs Cabinet for Health Services	1,664,748	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Health and Human Services (Continued)</u>				
Direct Programs (Continued):				
93.556	Promoting Safe and Stable Families (Note 9)	Cabinet for Families and Children	3,303,713	
		Cabinet for Health Services		
93.558	Temporary Assistance for Needy Families (Note 2) (Note 9)	Office of the Attorney General	208,445,415	
		Cabinet for Families and Children		
		Cabinet for Health Services		
		Kentucky Housing Corporation		
		Cabinet for Workforce Development		
93.563	Child Support Enforcement (Note 2) (Note 9)	Office of the Attorney General	41,173,059	
		Cabinet for Families and Children		
		Cabinet for Health Services		
93.568	Low-Income Home Energy Assistance (Note 2) (Note 9)	Cabinet for Families and Children	27,484,242	
		Cabinet for Health Services		
93.569	Community Services Block Grant (Note 9)	Cabinet for Families and Children	7,872,159	
		Cabinet for Health Services		
93.571	Community Services Block Grant Discretionary Awards - Community Food and Nutrition (Note 9)	Cabinet for Families and Children	60,678	
93.575	Child Care and Development Block Grant (Note 2) (Note 9)	Cabinet for Families and Children	13,844,066	
93.576	Refugee and Entrant Assistance - Discretionary Grants (Note 9)	Department of Education	313,688	
93.585	Empowerment Zones Program (Note 9)	Finance and Administration Cabinet	4,838,551	
93.586	State Court Improvement Program	Administrative Office of the Courts	125,699	
93.595	Welfare Reform Research, Evaluations and National Studies	Cabinet for Health Services	3,507,172	
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund (Note 2)	Cabinet for Families and Children	20,261,345	
93.597	Grants to States for Access and Visitation Programs (Note 9)	Cabinet for Families and Children	82,424	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Health and Human Services (Continued)</u>				
Direct Programs (Continued):				
93.600	Head Start	Department of Education	100,921	
		Office of the Governor		
93.603	Adoption Incentive Payments(Note 9)	Cabinet for Families and Children	75,359	
93.623	Runaway and Homeless Youth (Note 9)	Department of Juvenile Justice	52,984	
93.630	Developmental Disabilities Basic Support and Advocacy Grants (Note 9)	Cabinet for Health Services	1,298,211	
93.643	Children's Justice Grants to States (Note 9)	Department of Public Advocacy		
		Administrative Office of the Courts	185,054	
		Office of the Attorney General		
		Cabinet for Families and Children		
93.645	Child Welfare Services - State Grants	Cabinet for Families and Children	4,847,308	
93.652	Adoption Opportunities	Administrative Office of the Courts	243,417	
93.658	Foster Care - Title IV-E (Note 2)	Administrative Office of the Courts	55,287,902	
		Cabinet for Families and Children		
		Cabinet for Health Services		
		Department of Juvenile Justice		
93.659	Adoption Assistance	Cabinet for Families and Children	10,203,823	
93.667	Social Services Block Grant (Note 2) (Note 9)	Cabinet for Families and Children	27,479,210	
		Cabinet for Health Services		
		Department of Juvenile Justice		
93.669	Child Abuse and Neglect State Grants (Note 9)	Office of the Attorney General	1,683,232	
		Cabinet for Families and Children		
93.671	Family Violence Prevention and Services/Grants for Battered Women's Shelters-Grants to States and Indian Tribes (Note 9)	Cabinet for Families and Children	860,213	
		Cabinet for Health Services		
93.674	Independent Living (Note 9)	Cabinet for Families and Children	799,204	
93.767	State Children's Insurance Program (Note 2)	Cabinet for Families and Children	19,606,751	
		Cabinet for Health Services		
93.775	State Medicaid Fraud Control Units (Note 2)	Office of the Attorney General	1,108,577	
93.777	State Survey and Certification of Health Care Providers and Suppliers (Note 2)	Cabinet for Health Services	6,007,091	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Health and Human Services (Continued)</u>				
Direct Programs (Continued):				
93.778	Medical Assistance Program (Note 2) (Note 9)	Office of the Attorney General Cabinet for Families and Children Cabinet for Health Services	2,450,570,344	
93.779	Health Care Financing Research, Demonstrations and Evaluations (Note 9)	Cabinet for Health Services	353,927	
93.917	HIV Care Formula Grants (Note 9)	Cabinet for Health Services	4,423,838	
93.919	Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs (Note 9) (Note 13)	Cabinet for Health Services	2,084,771	25,000
93.931	Demonstration Grants to States for Community Scholarship (Note 9)	Cabinet for Health Services	25,638	
93.938	Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems (Note 9)	Department of Education	228,455	
93.940	HIV Prevention Activities - Health Department Based (Note 9) (Note 13)	Cabinet for Health Services	1,465,924	63,362
93.944	Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance (Note 9)	Cabinet for Health Services	119,045	
93.945	Assistance Programs for Chronic Disease Prevention and Control (Note 9)	Department of Education Cabinet for Health Services	948,798	
93.958	Block Grants for Community Mental Health Services (Note 9)	Cabinet for Health Services Cabinet for Workforce Development	5,270,576	
93.959	Block Grants for Prevention and Treatment of Substance Abuse (Note 2) (Note 9)	Department of Alcoholic Beverage Control Cabinet for Health Services	18,572,755	
93.977	Preventive Health Services - Sexually Transmitted Diseases Control Grants (Note 9) (Note 13)	Cabinet for Health Services	709,064	501,374
93.988	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems (Note 9)	Cabinet for Health Services	350,330	
93.991	Preventive Health and Health Services Block Grant (Note 9)	Cabinet for Health Services	2,445,528	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>U.S. Department of Health and Human Services (Continued)</u>				
Direct Programs (Continued):				
93.994	Maternal and Child Health Services Block Grant to the States (Note 9)	Commission for Children with Special Health Care Needs Cabinet for Health Services	13,223,264	
NA	FDA Tobacco Investigations	Department of Alcoholic Beverage Control	3,270	
NA	The Placement and Treatment of Neuropsychiatric Patients	Cabinet for Families and Children	229,260	
NA	Clinical Laboratory Improvement Act	Cabinet for Health Services	169,430	
Total U.S. Department of Health and Human Services			\$ 2,992,037,573	\$ 12,249,816
<u>U.S. Corporation for National and Community Service</u>				
Direct Programs:				
94.003	State Commissions (Note 9)	Cabinet for Families and Children	\$ 153,825	
94.004	Learn and Serve America - School and Community Based Programs (Note 9)	Department of Education Cabinet for Families and Children	332,227	
94.006	AmeriCorps (Note 9)	Cabinet for Families and Children	2,434,973	
94.009	Training and Technical Assistance	Cabinet for Families and Children	58,201	
94.011	Foster Grandparent Program (Note 9)	Cabinet for Health Services	539,878	
Total U.S. Corporation for National and Community Service			\$ 3,519,104	
<u>U.S. Social Security Administration</u>				
Direct Program:				
96.001	Social Security - Disability Insurance (Note 2)	Cabinet for Families and Children	\$ 36,249,749	
Total U.S. Social Security Administration			\$ 36,249,749	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001

Federal Grantor		State Agencies	Expenditures	
CFDA #		Expending Federal		
Program Title		Awards	Cash	Noncash
<u>Other Federal Assistance</u>				
Direct Program:				
NA	Joint Funding Administration (Note 8) (Note 9)	Department for Local Government	\$ 1,601,400	
Passed Through From Laurel County Fiscal Court:				
NA	Appalachia High Intensity Drug Trafficking Area Pass Through Grantor's # - I9PAPP501	Office of the Governor	89,376	
Total Other Federal Assistance			\$ 1,690,776	
Total Schedule of Expenditures of Federal Awards			\$4,920,901,924	\$ 533,668,566

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Purpose of the Schedule - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*.

Basis of Presentation - The accompanying Schedule of Expenditures of Federal Awards is presented in accordance with OMB Circular A-133. As defined in the Circular, federal financial assistance “. . . means assistance that non-federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance, but does not include amounts received as reimbursement for services rendered to individuals . . .” It includes awards received directly from federal agencies, or indirectly through other units of state and local governments. Accordingly, the accompanying schedule includes both cash and noncash federal financial assistance programs. Those programs that have not been assigned a catalog number, or for which the catalog number was not available, have been shown either at the bottom of the relevant federal grantor subheading or under the “Other Federal Assistance” subheading.

Reporting Entity - The accompanying schedule includes all federal financial assistance programs administered by the Commonwealth of Kentucky, except for those programs administered by the state universities. As allowed by the Single Audit Act Amendments of 1996 and OMB Circular A-133, the Commonwealth elected to exclude state universities from the statewide single audit, except as part of the audit of the general-purpose financial statements of the Commonwealth.

Basis of Accounting - The cash expenditures on the accompanying schedule are presented primarily on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed.

KRS 45.229 provides that the Finance and Administration Cabinet may, “. . . for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Note 1 - Purpose of the Schedule and Significant Accounting Policies (Continued)

Basis of Accounting (Continued)

The general-purpose financial statements of the Commonwealth are presented on the modified accrual or accrual basis of accounting, depending on fund type. Therefore, the Schedule of Expenditures of Federal Awards may not be directly traceable to the general-purpose financial statements in all cases.

The noncash expenditures presented on this schedule represent the noncash assistance expended by the Commonwealth during the period July 1, 2000 through June 30, 2001, using the method or basis of valuation as described in the notes to the schedule for each program. These noncash assistance programs are not reported in the general-purpose financial statements of the Commonwealth for the year ended June 30, 2001.

The schedules for five (5) state agencies that account for 93% of the total cash expenditures of federal awards are presented on the modified cash basis of accounting. They are:

Department of Education

Cabinet for Families and Children

Cabinet for Health Services

Transportation Cabinet

Cabinet for Workforce Development

The remaining state agencies' Schedules of Expenditures of Federal Awards are presented on the cash, modified cash, or accrual basis of accounting.

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Note 1 - Purpose of the Schedule and Significant Accounting Policies (Continued)

Inter-Agency Activity - Certain transactions relating to federal financial assistance may appear in the records of more than one state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the Commonwealth's Schedule of Expenditures of Federal Awards:

- (a) Federal moneys may be received by one state agency (primary state agency - recipient) and passed through to another state agency (secondary state agency - subrecipient) where the moneys are expended. Except for pass-throughs to state universities as discussed below, this inter-agency transfer activity is reported in the Commonwealth's schedule as follows:
- Under the primary state agency, the federal program is reported as a direct program. However, the transfer of money to the secondary state agency is not included in the primary state agency's expenditures.
 - Under the secondary state agency, the federal program is reported as a pass-through program. The expenditure of the transferred moneys is reported in the secondary agency's expenditures.

Because the Commonwealth's schedule excludes federal financial assistance related to state universities, when a state agency passes federal money to a state university, this is reported as an expenditure of that state agency.

- (b) Federal moneys received by a state agency and used to purchase goods or services from another state agency are reported in the Commonwealth's schedule only by the purchasing agency as an expenditure.

Note 2 - Type A Programs

Under the provisions of OMB Circular A-133, a Type A program for the Commonwealth means any program for which total expenditures of federal awards exceeded \$15 million for FY 01. Clusters are a group of closely related programs sharing common compliance requirements. A cluster of programs shall be considered as one program for determining Type A programs. In relation to noncash federal financial assistance programs, this threshold is generally applied to the amount of assistance expended during the year as presented on the noncash portion of the Schedule of Expenditures of Federal Awards, plus any cash expenditures under the same CFDA designation. In the case of guarantee type programs, this threshold is applied to the value of new guaranteed loans/debentures

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 2 - Type A Programs (Continued)

during the year, plus the balance of guaranteed loans/debentures from previous years for which the federal government still imposed continuing compliance requirements during the year, plus any interest subsidy, cash, or administrative cost allowance received. In relation to revolving loan type programs, this threshold is applied to the value of new loans during the year, plus the balance of loans from previous years which were outstanding during the year, plus the amount of interest income collected during the year.

The Commonwealth had the following programs (cash and noncash) which met the Type A program definition for the year ended June 30, 2001, some of which were administered by more than one (1) state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified nine (9) clusters among the Type A programs. These Type A programs and clusters were:

CFDA #	Program Title	Expenditures
10.550	Food Distribution	\$ 15,697,806
10.551	Food Stamps	344,117,592 a
10.553	School Breakfast Program	29,412,350 b
10.555	National School Lunch Program	90,879,266 b
10.556	Special Milk Program for Children	87,732 b
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children	81,331,341
10.558	Child and Adult Care Food Program	23,727,070
10.559	Summer Food Service Program for Children	3,065,808 b
10.561	State Administrative Matching Grants for Food Stamp Program	27,065,228 a
10.766	Community Facilities Loans and Grants	50,144,498
14.117	Mortgage Insurance--Homes	92,092,533
14.182	Lower Income Housing Assistance Program -- Section 8 New Construction/Substantial Rehabilitation	68,023,673 c
14.228	Community Development Block Grants/State's Program	39,530,487
14.239	HOME Investment Partnerships Program	15,796,929
14.856	Lower Income Housing Assistance Program -- Section 8 Moderate Rehabilitation	825,397 c
17.225	Unemployment Insurance	379,762,912
17.255	Workforce Investment Act	32,073,487
20.205	Highway Planning and Construction	511,179,709 d

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 2 - Type A Programs (Continued)

CFDA #	Program Title	Expenditures
64.114	Veterans Housing-Guaranteed and Insured Loans	8,155,705
66.458	Capitalization Grants for State Revolving Funds	8,600,211
66.468	Capitalization Grants for Drinking Water State Revolving Fund	6,774,653
84.010	Title I Grants to Local Educational Agencies	127,815,102
84.027	Special Education - Grants to States	59,922,124 e
84.032	Federal Family Education Loans	50,706,598 f
84.048	Vocational Education – Basic Grants to States	19,113,221
84.069	Leveraging Educational Assistance Partnership	516,502
84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	40,615,369
84.173	Special Education – Preschool Grants	8,964,427 e
84.203	Star Schools	319,719
93.558	Temporary Assistance for Needy Families	208,445,415
93.563	Child Support Enforcement	41,173,059
93.568	Low-Income Home Energy Assistance	27,484,242
93.575	Child Care and Development Block Grant	13,844,066 g
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund	20,261,345 g
93.658	Foster Care - Title IV-E	55,287,902
93.667	Social Services Block Grant	27,479,210
93.767	State Children’s Insurance Program	19,606,751
93.775	State Medicaid Fraud Control Units	1,108,577 h
93.777	State Survey and Certification of Health Care Providers and Suppliers	6,007,091 h
93.778	Medical Assistance Program	2,450,570,344 h
93.959	Block Grants for Prevention and Treatment of Substance Abuse	18,572,755
96.001	Social Security – Disability Insurance	36,249,749 i
Total Type A Programs		<u><u>\$ 5,062,407,955</u></u>

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Note 2 - Type A Programs (Continued)

Identified clusters include:

- a – Food Stamp Cluster (Cabinet for Families and Children)
- b – Child Nutrition Cluster (Department of Education)
- c – Section 8 Project-Based Cluster (Kentucky Housing Corporation)
- d – Highway Planning and Construction Cluster (Transportation Cabinet)
- e – Special Education Cluster (Department of Education)
- f – Student Financial Aid Cluster (Kentucky Higher Education Assistance Authority, Kentucky Higher Education Student Loan Corporation)
- g – Child Care Cluster (Cabinet for Families and Children)
- h – Medicaid Cluster (Cabinet for Families and Children, Cabinet for Health Services)
- i – Disability Insurance/SSI Cluster (Cabinet for Families and Children)

Note 3 - Federally Assisted Loan Programs

The Commonwealth has several loan programs made possible with initial advances in prior years from the federal government. In addition, the federal government guarantees some loan programs.

a) The Kentucky Rural Rehabilitation Student Loan Program was initially awarded \$672,629 in 1970 by the U.S. Farmers Home Administration. Since 1970, the program has operated on interest from student loans outstanding and on income from investments administered by the Office of Financial Management. The Department of Agriculture is no longer in the business of making student loans and reassigned all loans in payment compliance to the Kentucky Higher Education Assistance Authority (KHEAA). The Department of Agriculture retained only those loans that had a delinquent payment history. This program is currently in phase-out status, with authorization from the U.S. Department of Agriculture (USDA) to eliminate the principal through issuance of specific grants and scholarships. Most outstanding loans have been classified as contingent uncollectible liabilities. When loan payments are received, they are directly deposited into the principal account. The total amount of money in the investment account as of June 30, 2001 was \$886,138. Student loans and investments earned interest of \$53,053. Outstanding student loans totaled \$64,536. The total grants and scholarships authorized by the USDA in FY 01 totaled \$106,417.

b) Total moneys for the Gas System Restoration Project, administered by the Department for Local Government (CFDA #11.307), consist of \$3,150,000 from the U.S. Economic Development Administration; \$500,000 from the U.S. Appalachian Regional Commission; and \$650,000 in state matching money, for a total commitment to the

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 3 - Federally Assisted Loan Programs (Continued)

revolving loan program of \$4,300,000. All monies had been received and paid out for loans as of June 30, 2001. In addition, principal and interest repaid is available for lending.

c) The Kentucky Higher Education Student Loan Corporation issues revenue bonds to purchase student loans authorized under the Federal Family Education Loans program (CFDA #84.032). The Kentucky Higher Education Assistance Authority guarantees substantially all loans made and purchased by the Kentucky Higher Education Student Loan Corporation. The U.S. Department of Education provides for reinsurance of loans guaranteed by the Kentucky Higher Education Assistance Authority. Outstanding loans guaranteed under this program totaled \$1,947,932,103 as of June 30, 2001.

d) The Kentucky Infrastructure Authority administers wastewater revolving loan programs (CFDA #66.458 and 66.468) funded by the U.S. Environmental Protection Agency's Capitalization Grants for State Revolving Funds. During FY 01, the Kentucky Infrastructure Authority issued loans totaling \$12,341,489, with outstanding loans of \$209,986,967 at year end.

e) The Department of Housing and Urban Development's Mortgage Insurance-Homes Program (CFDA #14.117), Department of Agriculture's Rural Housing Service Community Facilities Loans and Grants (CFDA #10.766), and Department of Veterans Affairs' Veterans Housing - Guaranteed and Insured Loans (CFDA #64.114) represent the loans originated in FY 01 by the Kentucky Housing Corporation. The cumulative outstanding balance of the Mortgage Insurance Program, Rural Housing Service Community Facilities Loans and Grants Program, and Veterans Housing and Guaranteed Loans Program loans originated by the Kentucky Housing Corporation is \$504,827,579, \$192,397,693, and \$59,183,007, respectively at June 30, 2001.

Note 4 - Activity Occurring in Programs with Inventoriable Items

The Cabinet for Families and Children (CFC) received, stored, and distributed inventory items related to the Food Stamps (CFDA #10.551) program in prior years. However, due to the Electronic Benefit Transfer (EBT) distribution of food stamps benefits, inventory is no longer applicable.

The Department of Agriculture operates a warehouse in Louisville, Kentucky for the Commodity Supplemental Food Program (CFDA #10.565). The dollar value of the inventory, based on the USDA Commodity File dated June 2001, is as follows:

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 4 - Activity Occurring in Programs with Inventoriable Items (Continued)

	Commodity Supplemental Food Program CFDA #10.565
Beginning Inventory, July 1, 2000	\$ 294,778
Received	1,443,656
Issued to Recipients	(1,111,913)
Ending Inventory, June 30, 2001	\$ 626,521

Note 5 - Unemployment Insurance (CFDA #17.225)

The Commonwealth paid out \$357,646,539 in benefits in FY 01. The amounts shown on the accompanying Schedule of Expenditures of Federal Awards reflect both the amount expended for benefits from the Trust Fund and an additional \$22,116,373 of federal funds expended for administration of the program, resulting in a combined total of \$379,762,912 in federal expenditures.

Note 6 - Highway Planning and Construction (CFDA #20.205)

The information reported for this program represents the activity of all open projects during the year ended June 30, 2001. These projects were funded from several apportionments. Apportionments refer to a federal statutorily prescribed division or assignment of funds. The expenditures reflected on the Schedule of Expenditures of Federal Awards include those for advance construction projects which are not yet under agreements with the Federal Highway Administration.

Program Income - The Highway Planning and Construction Program earned program income of \$584,606 in the year ended June 30, 2001. This income was earned in the right-of-way phase through the sale and rental of real property. Income earned in this manner was classified as a negative expenditure, resulting in a reduction to federal expenditures for the current year.

Refunds - Expenditures for the Highway Planning and Construction Program were shown net of any refunds, resulting from a reimbursement of prior or current year expenditures. Refunds totaled \$3,411,143 for the year ended June 30, 2001.

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 7 - Outdoor Recreation - Acquisition, Development and Planning
(CFDA # 15.916) and Recreational Trails Program (CFDA # 20.219)

Administrative costs are shown as expended when received from the federal government. These costs are recovered through a negotiated fixed-indirect cost rate. Any over or under recovery will be recouped in the future.

Note 8 - Joint Funding Administration

The Joint Funding Administration Program consists of grants from the following federal agencies:

- U.S. Department of Commerce
- U.S. Department of Housing and Urban Development
- U.S. Appalachian Regional Commission

Note 9 - Subrecipient Activity

A subrecipient is a non-federal entity that expends federal awards received from a pass-through entity to carry out a federal program. The following list summarizes the amount of federal funds sent to subrecipients.

CFDA #	Federal Program Name	Amount Sent
10.550	Food Distribution	\$ 15,697,806
10.553	School Breakfast Program	29,071,256
10.555	National School Lunch Program	90,296,307
10.556	Special Milk Program for Children	87,732
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children	13,826,952
10.558	Child and Adult Care Food Program	23,484,389
10.559	Summer Food Service Program for Children	2,991,048
10.561	State Administrative Matching Grants for Food Stamp Program	140,749
10.570	Nutrition Program for the Elderly (Commodities)	1,722,933
10.664	Cooperative Forestry Assistance	281,054
11.305	Economic Development – State and Local Economic Development Planning	51,710
14.185	Homeownership and Opportunity for People Everywhere	24,886

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 9 - Subrecipient Activity (Continued)

CFDA #	Federal Program Name	Amount Sent
14.228	Community Development Block Grants/State's Program	38,952,507
14.231	Emergency Shelter Grants Program	1,436,867
14.235	Supportive Housing Program	3,019,006
14.238	Shelter Plus Care	193,337
14.239	HOME Investment Partnerships Program	9,513,433
14.241	Housing Opportunities for Persons with AIDS	1,333,461
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining	2,567
15.252	Abandoned Mine Land Reclamation (AMLR) Program	6,113,402
15.615	Cooperative Endangered Species Conservation Fund	2,225
15.904	Historic Preservation Fund Grants-In-Aid	174,100
15.916	Outdoor Recreation - Acquisition, Development and Planning	91,286
16.523	Juvenile Accountability Incentive Block Grants	304,942
16.540	Juvenile Justice and Delinquency Prevention – Allocation to States	564,608
16.542	National Institute for Juvenile Justice and Delinquency Prevention	628,538
16.548	Title V - Delinquency Prevention Program	470,104
16.549	Part E - State Challenge Activities	105,536
16.575	Crime Victim Assistance	4,273,606
16.579	Byrne Formula Grant Program	3,831,516
16.588	Violence Against Women Formula Grants	1,677,286
16.589	Rural Domestic Violence and Child Victimization Enforcement Grant Program	108,489
16.590	Grants to Encourage Arrest Policies and Enforcement of Protection Orders	39,103
16.592	Local Law Enforcement Block Grants Program	469,117
16.607	Bulletproof Vest Partnership Program	38,576
16.727	Enforcing Underage Drinking Laws Program	77,034
17.225	Unemployment Insurance	21,778
17.235	Senior Community Service Employment Program	1,546,132
17.246	Employment and Training Assistance - Dislocated Workers	297,117
17.249	Employment Services and Job Training Pilots – Demonstrations and Research	274,171

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 9 - Subrecipient Activity (Continued)

CFDA #	Federal Program Name	Amount Sent
17.250	Job Training Partnership Act	1,020,853
17.253	Welfare-to-Work Grants to States and Localities	8,012,146
17.255	Workforce Investment Act	29,877,774
20.218	National Motor Carrier Safety	106,016
20.219	Recreational Trails Program	402,433
20.505	Federal Transit-Metropolitan Planning Grants	328,197
20.507	Federal Transit - Formula Grants	2,432,977
20.509	Formula Grants for Other Than Urbanized Areas	5,093,691
20.513	Capital Assistance Program for Elderly Persons and Persons with Disabilities	1,405,197
20.600	State and Community Highway Safety	2,087,222
23.002	Appalachian Area Development	39,873
23.011	Appalachian State Research, Technical Assistance, and Demonstration Projects	43,957
45.025	Promotion of the Arts - Partnership Agreements	259,625
45.310	State Library Program	627,191
66.032	State Indoor Radon Grants	209,288
66.454	Water Quality Management Planning	27,500
66.461	Wetlands Grants	33,891
66.463	Water Quality Cooperative Agreements	13,991
66.606	Surveys, Studies, Investigations and Special Purpose Grants	106,632
66.701	Toxic Substances Compliance Monitoring Cooperative Agreements	10,726
66.707	TSCA Title IV State Lead Grants-Certification of Lead-Based Paint Professionals	73,516
66.708	Pollution Prevention Grants Program	65,767
81.041	State Energy Program	168,067
81.042	Weatherization Assistance for Low-Income Persons	2,918,169
81.119	State Energy Program Special Projects	11,555
81.502	Paducah Gaseous Diffusion Plant Environmental Monitoring and Oversight	371,191
83.544	Public Assistance Grants	3,491,056
83.548	Hazard Mitigation Grant	2,294,095
83.549	Chemical Stockpile Emergency Preparedness Program	1,920,330
83.552	Emergency Management Performance Grants	1,546,361
84.002	Adult Education - State Grant Program	5,509,013

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 9 - Subrecipient Activity (Continued)

CFDA #	Federal Program Name	Amount Sent
84.010	Title I Grants to Local Educational Agencies	126,311,971
84.011	Migrant Education - Basic State Grant Program	9,856,481
84.013	Title I Program for Neglected and Delinquent Children	5,417
84.023	Special Education - Innovation and Development	94,628
84.027	Special Education - Grants to States	57,091,900
84.048	Vocational Education - Basic Grants to States	16,942,450
84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States	347,756
84.128	Rehabilitation Services-Service Projects	77,678
84.162	Immigrant Education	569,798
84.169	Independent Living - State Grants	67,671
84.173	Special Education - Preschool Grants	8,520,636
84.177	Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind	7,620
84.181	Special Education - Grants for Infants and Families with Disabilities	2,117,001
84.185	Byrd Honors Scholarships	531,000
84.186	Safe and Drug-Free Schools and Communities - State Grants	5,879,128
84.187	Supported Employment Services For Individuals With Severe Disabilities	144,193
84.194	Bilingual Education Support Services	1,500
84.196	Education for Homeless Children and Youth	481,653
84.213	Even Start - State Educational Agencies	2,045,200
84.215	Fund for the Improvement of Education	75,334
84.216	Capital Expenses	356,075
84.224	Assistive Technology	205,881
84.243	Tech-Prep Education	1,085,364
84.276	Goals 2000 - State and Local Education Systemic Improvement Grants	5,415,929
84.278	School-to-Work Implementation Grant	89,436
84.281	Eisenhower Professional Development State Grants	4,284,368
84.293	Foreign Language Assistance	20,204
84.298	Innovative Education Program Strategies	4,013,804
84.318	Technology Literacy Challenge Fund Grants	5,135,460
84.323	Special Education - State Program Improvement Grants for Children with Disabilities	905,612

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 9 - Subrecipient Activity (Continued)

CFDA #	Federal Program Name	Amount Sent
84.326	Special Education - Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	105,762
84.327	Special Education - Technology and Media Services for Individuals with Disabilities	221,060
84.330	Advanced Placement Incentive Program	20,924
84.332	Comprehensive School Reform Demonstration	2,021,600
84.334	Gaining Early Awareness and Readiness for Undergraduate Programs	8,900
84.338	Reading Excellence	2,720,117
84.340	Class Size Reduction	13,690,487
93.041	Special Programs for the Aging - Title VII, Chapter 3 - Programs for Prevention of Elder Abuse, Neglect, and Exploitation	65,702
93.042	Special Programs for the Aging - Title VII, Chapter 2 - Long Term Care Ombudsman Services for Older Individuals	39,065
93.043	Special Programs for the Aging - Title III, Part F - Disease Prevention and Health Promotion Services	201,017
93.044	Special Programs for the Aging - Title III, Part B - Grants for Supportive Services and Senior Centers	4,657,300
93.045	Special Programs for the Aging - Title III, Part C - Nutrition Services	6,949,634
93.046	Special Programs for the Aging - Title III, Part D - In-Home Services for Frail Older Individuals	12,988
93.048	Special Programs for the Aging - Title IV - Training, Research and Discretionary Projects and Programs	15,563
93.110	Maternal and Child Health Federal Consolidated Programs	87,585
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	828,362
93.130	Primary Care Services - Resource Coordination and Development - Primary Care Offices	52,248
93.136	Injury Prevention and Control Research and State and Community Based Programs	306,689
93.150	Projects for Assistance in Transition from Homelessness (PATH)	300,000
93.217	Family Planning - Services	4,187,803

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 9 - Subrecipient Activity (Continued)

CFDA #	Federal Program Name	Amount Sent
93.230	Consolidated Knowledge Development and Application (KD&A) Program	4,274,656
93.234	Traumatic Brain Injury - State Demonstration Grant Program	10,316
93.235	Abstinence Education	462,411
93.238	Cooperative Agreements for State Treatment Outcomes and Performance Pilot Studies Enhancement	473,278
93.262	Occupational Safety and Health Research Grants	97,820
93.268	Immunization Grants	1,275,751
93.283	Centers for Disease Control and Prevention – Investigations and Technical Assistance	1,334,232
93.556	Promoting Safe and Stable Families	2,036,399
93.558	Temporary Assistance for Needy Families	10,486,489
93.563	Child Support Enforcement	20,788,383
93.568	Low-Income Home Energy Assistance	27,259,370
93.569	Community Services Block Grant	7,733,701
93.571	Community Services Block Grant Discretionary Awards - Community Food and Nutrition	60,678
93.575	Child Care and Development Block Grant	8,560,268
93.576	Refugee and Entrant Assistance Discretionary Grants	307,769
93.585	Empowerment Zones Program	4,838,551
93.597	Grants to States for Access and Visitation Programs	82,162
93.603	Adoption Incentive Payments	1,265
93.623	Runaway and Homeless Youth	45,943
93.630	Developmental Disabilities Basic Support and Advocacy Grants	434,808
93.643	Children's Justice Grants to States	60,202
93.667	Social Services Block Grant	445,551
93.669	Child Abuse and Neglect State Grants	1,022,158
93.671	Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes	857,435
93.674	Independent Living	242,692
93.778	Medical Assistance Program	2,680,891
93.779	Health Care Financing Research, Demonstrations and Evaluations	274,244
93.917	HIV Care Formula Grants	4,329,759

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 9 - Subrecipient Activity (Continued)

CFDA #	Federal Program Name	Amount Sent
93.919	Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs	1,852,219
93.931	Demonstration Grants to States for Community Scholarship	8,652
93.938	Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	95,240
93.940	HIV Prevention Activities - Health Department Based	1,054,099
93.944	Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	42,811
93.945	Assistance Programs for Chronic Disease Prevention and Control	551,770
93.958	Block Grants for Community Mental Health Services	5,191,300
93.959	Block Grants for Prevention and Treatment of Substance Abuse	18,099,416
93.977	Preventive Health Services-Sexually Transmitted Diseases Control Grants	159,221
93.988	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	326,722
93.991	Preventive Health and Health Services Block Grant	2,438,165
93.994	Maternal and Child Health Services Block Grant to the States	8,294,519
94.003	State Commissions	1,355
94.004	Learn and Serve America - School and Community Based Programs	294,889
94.006	AmeriCorps	1,904,842
94.011	Foster Grandparent Program	122,647
NA	Chemical Demilitarization and Remediation Activity for Hazardous Waste Activities at Chemical Demilitarization Facilities	8,759
NA	HUD Disaster Recovery Initiative	836,270
NA	Joint Funding Administration	1,601,400
Total Amounts Sent to Subrecipients		\$ 756,280,398

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Note 10 - Community Development Block Grants/State's Program (CFDA #14.228)

The Commonwealth matches the federal portion of administration dollar for dollar. Cash expenditures include the federal portion of administration.

Note 11 - Wildlife Restoration (CFDA #15.611)

The Department of Fish and Wildlife Resources leases properties from the U.S. Army Corps of Engineers for Condition three (3) and Condition five (5) Projects. These projects stipulate that the properties leased be managed for wildlife purposes and may produce income. The leases for wildlife management rights on these properties are non-monetary. At present, the Department of Fish and Wildlife Resources leases the following properties:

- Barlow Bottoms-Olmstead
- Barren River
- Birdsville Island
- Green River
- Dewey Lake
- Fishtrap Lake
- Lake Cumberland
- Paintsville Lake
- Sloughs-Grassy Pond

Any expenditure in excess of revenue from each property listed above will be eligible for reimbursement under the Wildlife Restoration grant (CFDA 15.611) from the U.S. Department of the Interior. The properties listed above are not reimbursed with federal funds if the grant has already been expended to manage other wildlife properties. Since the grant was used to manage other properties, no expenditures for leased properties were federally reimbursed in FY 01.

Note 12 - Workforce Investment Act (CFDA #17.255)

The Workforce Investment Act program (WIA) has three (3) basic programs, Adult, Youth, and Dislocated Workers. For FY 01, all expenditures were made under WIA - CFDA 17.255. Beginning in FY 02, expenditures will be identified in three (3) separate programs:

- CFDA 17.258 – WIA Adult Program,
- CFDA 17.259 – WIA Youth Activities, and
- CFDA 17.260 – WIA Dislocated Workers.

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 13 - Noncash Expenditure Programs

The Commonwealth had 20 noncash programs in FY 01. These noncash programs and a description of the method/basis of valuation follow.

CFDA #	Program Title	State Agency	Amount	Method/Basis of Valuation
10.550	Food Distribution	Department of Agriculture	\$ 15,697,806	USDA's value at the time of delivery to recipient agencies.
10.551	Food Stamps	Cabinet for Families and Children	344,117,592	EBT Issuance.
10.565	Commodity Supplemental Food Program	Department of Agriculture	1,111,913	Quantity issued to recipients valued at USDA's June 2001 prices.
10.569	Emergency Food Assistance Program (Food Commodities)	Department of Agriculture	5,159,418	USDA's value at the time of delivery to recipient agencies.
10.664	Cooperative Forestry Assistance	Natural Resources and Environmental Protection Cabinet	3,552,638	Original purchase price.
10.766	Community Facilities Loans and Grants	Kentucky Housing Corporation	50,144,498	Book value of loans.
10.914	Wildlife Habitat Incentive Program	Department of Fish and Wildlife Resources	21,000	Office space (office supplies and telephone).
14.117	Mortgage Insurance-Homes	Kentucky Housing Corporation	92,092,533	Book value of loans.

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 13 - Noncash Expenditure Programs (Continued)

CFDA #	Program Title	State Agency	Amount	Method/Basis of Valuation
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining	Natural Resources and Environmental Protection Cabinet	18,490	Inventory of property.
15.252	Abandoned Mine Land Reclamation (AMLR) Program	Natural Resources and Environmental Protection Cabinet	26,600	Matched project costs.
15.808	U.S. Geological Survey – Research and Data Acquisition	Natural Resources and Environmental Protection Cabinet	284,151	Split costs for investigation and network operations.
39.003	Donation of Federal Surplus Personal Property	Finance and Administration Cabinet	945,851	23.3% of federal acquisition cost (\$4,059,447).
64.114	Veterans Housing – Guaranteed and Insured Loans	Kentucky Housing Corporation	8,155,705	Book value of loans.
66.460	Nonpoint Source Implementation Grants	Natural Resources and Environmental Protection Cabinet	22,590	Excess salary payment over grant.
66.606	Surveys, Studies, Investigations and Special Purpose Grants	Natural Resources and Environmental Protection Cabinet	67,965	EPA in-kind contribution.
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	Cabinet for Health Services	82,418	Per authorized award for personnel costs and travel.

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 13 - Noncash Expenditure Programs (Continued)

CFDA #	Program Title	State Agency	Amount	Method/Basis of Valuation
93.268	Immunization Grants	Cabinet for Health Services	11,577,662	Per authorized award for personnel, vaccine costs, and travel.
93.919	Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs	Cabinet for Health Services	25,000	Per authorized personnel costs.
93.940	HIV Prevention Activities - Health Department Based	Cabinet for Health Services	63,362	Per authorized personnel costs.
93.977	Preventive Health Services - Sexually Transmitted Diseases Control Grants	Cabinet for Health Services	501,374	Per authorized personnel costs and travel.
Total Noncash Expenditures			<u>\$ 533,668,566</u>	

Note 14 - Zero Expenditure Programs

These programs had no expenditures during FY 01. They included programs with no activity during the year such as old programs not officially closed out or new programs issued late in the fiscal year. They also included programs with activity other than expenditures.

REPORTS ON COMPLIANCE AND ON INTERNAL CONTROL



EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

Report on Compliance and on Internal Control Over Financial Reporting
Based on an Audit of the General-Purpose Financial Statements
Performed in Accordance With
Government Auditing Standards

To the People of Kentucky
Honorable Paul E. Patton, Governor
T. Kevin Flanery, Secretary
Finance and Administration Cabinet

We have audited the general-purpose financial statements of the Commonwealth of Kentucky as of and for the year ended June 30, 2001, and have issued our report thereon dated December 21, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Several agencies were audited for compliance and internal control requirements in accordance with *Government Auditing Standards* by other auditors, whose reports thereon have been furnished to us.

Compliance

As part of obtaining reasonable assurance about whether the Commonwealth's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed seven (7) instances of noncompliance that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 01-FAC2-3, 01-LAB1-24, 01-CPE3-27, 01-CPE4-28, 01-CPE5-29, 01-CPE6-30, and 01-CPE7-31. We also noted certain immaterial instances of noncompliance, which we have reported to management.

Report on Compliance and on Internal Control Over
Financial Reporting Based on an Audit of the General-Purpose
Financial Statements Performed in Accordance With *Government Auditing Standards*
(Continued)

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commonwealth's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Commonwealth's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 01-CFC1-1, 01-FAC1-2, 01-FAC2-3, 01-FAC3-4, 01-FAC4-5, 01-FAC5-6, 01-FAC6-7, 01-FAC7-8, 01-GOT1-9, 01-CHS1-10, 01-CHS2-11, 01-CHS3-12, 01-CHS4-13, 01-CHS5-14, 01-CHS6-15, 01-LAB2-25, 01-LAB3-26, 01-LAB4-16, 01-PERS1-17, 01-REV1-18, 01-REV2-32, 01-REV3-19, 01-KST1-20, 01-CWD1-21, 01-CWD2-22, 01-CWD3-23, 01-CWD4-33, and 01-CWD5-34.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 01-LAB2-25, 01-LAB3-26, 01-REV2-32, 01-CWD4-33, and 01-CWD5-34 to be material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management.

Report on Compliance and on Internal Control Over
Financial Reporting Based on an Audit of the General-Purpose
Financial Statements Performed in Accordance With *Government Auditing Standards*
(Continued)

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in black ink, appearing to read "Ed Hatchett", with a horizontal line extending from the end of the signature.

Edward B. Hatchett, Jr.
Auditor of Public Accounts

December 21, 2001



EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

Report on Compliance With Requirements Applicable to Each
Major Program and on Internal Control Over Compliance in
Accordance With OMB Circular A-133 and on the
Schedule of Expenditures of Federal Awards

To the People of Kentucky
Honorable Paul E. Patton, Governor
T. Kevin Flanery, Secretary
Finance and Administration Cabinet

Compliance

We have audited the compliance of the Commonwealth of Kentucky with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2001. The Commonwealth's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Commonwealth's management. Our responsibility is to express an opinion on the Commonwealth's compliance based on our audit.

Several agencies were audited for internal control and compliance requirements in accordance with OMB Circular A-133 by other auditors, whose reports thereon have been furnished to us, and our opinion presented herein, insofar as it relates to these agencies listed in Appendix 1 to this report, is based on the reports of the other auditors.

The Commonwealth's general-purpose financial statements included the operations of the state universities, which expended \$446,133,636 in federal awards that is not included in the schedule of expenditures of federal awards during the year ended June 30, 2001. Our audit, described below, did not include the operations of the state universities because they engaged other auditors to perform an audit in accordance with OMB Circular A-133.

Report on Compliance With Requirements Applicable to Each
Major Program and on Internal Control Over Compliance in
Accordance With OMB Circular A-133 and on the
Schedule of Expenditures of Federal Awards
(Continued)

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Commonwealth's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Commonwealth's compliance with those requirements.

As described in item 01-CWD13-56 and 01-CWD14-57 in the accompanying schedule of findings and questioned costs, the Cabinet for Workforce Development did not comply with requirements regarding subrecipient monitoring that are applicable to its Workforce Investment Act program. Compliance with such requirements is necessary, in our opinion, for the Cabinet for Workforce Development to comply with the requirements applicable to that program.

In our opinion, based on our audit and the reports of other auditors, except for the noncompliance described in the preceding paragraph, the Commonwealth complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2001. The results of our auditing procedures also disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 01-AGR1-35, 01-CFC2-36, 01-CFC5-39, 01-CFC7-41, 01-MIL1-46, 01-CPE1-47, 01-CPE2-48, 01-CWD11-54, and 01-CWD12-55.

Internal Control Over Compliance

The management of the Commonwealth is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Commonwealth's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Report on Compliance With Requirements Applicable to Each
Major Program and on Internal Control Over Compliance in
Accordance With OMB Circular A-133 and on the
Schedule of Expenditures of Federal Awards
(Continued)

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Commonwealth's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 01-CFC2-36, 01-CFC3-37, 01-CFC4-38, 01-CFC5-39, 01-CFC6-40, 01-CFC7-41, 01-CHS9-42, 01-CHS10-43, 01-CHS11-44, 01-CHS12-45, 01-TC1-49, 01-CWD7-50, 01-CWD8-51, 01-CWD9-52, 01-CWD10-53, 01-CWD11-54, 01-CWD12-55, 01-CWD13-56, and 01-CWD14-57.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 01-CWD13-56 and 01-CWD14-57 to be material weaknesses. We also noted other matters involving internal control over compliance which we have communicated to management.

Schedule of Expenditures of Federal Awards

We have audited the general-purpose financial statements of the Commonwealth as of and for the year ended June 30, 2001, and have issued our report thereon dated December 21, 2001. Our audit was performed for the purpose of forming an opinion on the general-purpose financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the general-purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general-purpose financial statements taken as a whole.

Several schedules of expenditures of federal awards were audited by other auditors, whose reports thereon have been furnished to us, and our opinion presented herein, insofar as it relates to these agencies listed in Appendix 1 to this report, is based on the reports of the other auditors.

Report on Compliance With Requirements Applicable to Each
Major Program and on Internal Control Over Compliance in
Accordance With OMB Circular A-133 and on the
Schedule of Expenditures of Federal Awards
(Continued)

The general-purpose financial statements of the Commonwealth are prepared on an accrual/modified accrual basis of accounting. However, the schedule of expenditures of federal awards of the Commonwealth is prepared on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. Accordingly, the schedule of expenditures of federal awards is not intended to present the expenditures of federal awards in conformity with accounting principles generally accepted in the United States of America.

In our opinion, based on our audit and the reports of other auditors, except for the effect of the application of a different basis of accounting as explained above, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the Commonwealth's general-purpose financial statements taken as a whole.

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in black ink, appearing to read "Ed Hatchett", with a stylized flourish at the end.

Edward B. Hatchett, Jr.
Auditor of Public Accounts

Schedule of Expenditures of Federal Awards
December 21, 2001

April 30, 2002

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001**

SECTION 1 – SUMMARY OF AUDITOR’S RESULTS

Financial Statement Accounts

Financial Statement Accounts: We issued an unqualified opinion on the general-purpose financial statements of the Commonwealth as of and for the year ended June 30, 2001.

Internal Control Over Financial Reporting: Our consideration of the Commonwealth’s internal control over financial reporting disclosed 28 reportable conditions. We believe that five (5) of the reportable conditions are material weaknesses. The reportable conditions and material weaknesses, which were disclosed during our audit of the general-purpose financial statements of the Commonwealth, are applicable to the following:

<u>AGENCY</u>	<u>NUMBER & TYPE OF FINDINGS REPORTABLE</u>	<u>MATERIAL</u>
Cabinet for Families and Children (01-CFC1-1)	1	
Finance and Administration Cabinet (01-FAC1-2, 01-FAC2-3, 01-FAC3-4, 01-FAC4-5, 01-FAC5-6, 01-FAC6-7, and 01-FAC7-8)	7	
Governor’s Office for Technology (01-GOT1-9)	1	
Cabinet for Health Services (01-CHS1-10, 01-CHS2-11, 01-CHS3-12, 01-CHS4-13, 01-CHS5-14, and 01-CHS6-15)	6	
Labor Cabinet (01-LAB2-25, 01-LAB3-26, and 01-LAB4-16)	1	2
Personnel Cabinet (01-PERS1-17)	1	
Revenue Cabinet (01-REV1-18, 01-REV2-32, and 01-REV3-19)	2	1
Office of the Kentucky State Treasurer (01-KST1-20)	1	
Cabinet for Workforce Development (01-CWD1-21, 01-CWD2-22, 01-CWD3-23, 01-CWD4-33, and 01-CWD5-34)	3	2

The reportable conditions and material weaknesses are presented in detail in Section 2 - Financial Statement Findings of the Schedule of Findings and Questioned Costs.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)

Financial Statement Accounts (Continued)

Compliance: In relation to the audit of the general-purpose financial statements of the Commonwealth, and the Schedule of Expenditures of Federal Awards, the results of our tests disclosed seven (7) instances of noncompliance that are required to be reported under *Government Auditing Standards*. We believe six (6) of the instances of noncompliance are material.

<u>AGENCY</u>	<u>NUMBER & TYPE OF FINDINGS</u>	
	<u>REPORTABLE</u>	<u>MATERIAL</u>
Finance and Administration Cabinet (01-FAC2-3)	1	
Labor Cabinet (01-LAB1-24)		1
Council on Postsecondary Education (01-CPE3-27, 01-CPE4-28, 01-CPE5-29, 01-CPE6-30, and 01-CPE7-31)		5

Federal Awards and Schedule of Expenditures of Federal Awards

Compliance: We issued a qualified opinion on the Commonwealth’s compliance with the requirements applicable to one (1) of its major federal programs. The Cabinet for Workforce Development’s Workforce Investment Act program did not comply with requirements regarding subrecipient monitoring. All other programs received an unqualified opinion.

Also, the results of our auditing procedures disclosed 11 instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133. We believe two (2) of the instances of noncompliance are material. These findings are applicable to the following agencies of the Commonwealth:

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)

Federal Awards and Schedule of Expenditures of Federal Awards (Continued)

<u>AGENCY</u>	<u>NUMBER & TYPE OF FINDINGS</u>	
	<u>REPORTABLE</u>	<u>MATERIAL</u>
Department of Agriculture (01-AGR1-35)	1	
Cabinet for Families and Children (01-CFC2-36, 01-CFC5-39, and 01-CFC7-41)	3	
Department of Military Affairs (01-MIL1-46)	1	
Council on Postsecondary Education (01-CPE1-47 and 01-CPE2-48)	2	
Cabinet for Workforce Development (01-CWD11-54, 01-CWD12-55, 01-CWD13-56, and 01-CWD14-57)	2	2

The findings relative to compliance with requirements applicable to each of its major federal programs are presented in Section 3 - Federal Awards Findings and Questioned Costs of the Schedule of Findings and Questioned Costs.

Internal Control Over Compliance: Our consideration of the Commonwealth’s internal control over compliance disclosed 19 reportable conditions. We believe that two (2) of the reportable conditions are material weaknesses. The reportable conditions, which were disclosed during our audit, are applicable to the following agencies of the Commonwealth:

<u>AGENCY</u>	<u>NUMBER & TYPE OF FINDINGS</u>	
	<u>REPORTABLE</u>	<u>MATERIAL</u>
Cabinet for Families and Children (01-CFC2-36, 01-CFC3-37, 01-CFC4-38, 01-CFC5-39, 01-CFC6-40, 01-CFC7-41)	6	
Cabinet for Health Services (01-CHS9-42, 01-CHS10-43, 01-CHS11-44, and 01-CHS12-45)	4	
Transportation Cabinet (01-TC1-49)	1	
Cabinet for Workforce Development (01-CWD7-50, 01-CWD8-51, 01-CWD9-52, 01-CWD10-53, 01-CWD11-54, 01-CWD12-55, 01-CWD13-56, and 01-CWD14-57)	6	2

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)

Federal Awards and Schedule of Expenditures of Federal Awards (Continued)

The reportable conditions relative to the Commonwealth's internal control over compliance are presented in Section 3 - Federal Awards Findings and Questioned Costs of the Schedule of Findings and Questioned Costs.

Schedule of Expenditures of Federal Awards: We issued a qualified opinion on the Commonwealth’s Schedule of Expenditures of Federal Awards because the schedule was presented on a basis of accounting that was not in conformance with accounting principles generally accepted in the United States of America as described in Note 1 of the schedule. The opinion was issued in relation to the general-purpose financial statements of the Commonwealth taken as a whole.

Identification of Major Programs Audited

OMB Circular A-133 defines a major program as “a Federal program determined by the auditor to be a major program in accordance with section __.520 or a program identified as a major program by the Federal awarding agency or pass-through entity in accordance with section __.215 (c).” Section __.520 states, “[t]he auditor shall use a risk-based approach to determine which Federal programs are major programs.” The following is a list of major Type A programs audited:

CFDA #	Program Title	Expenditures
10.550	Food Distribution	\$ 15,697,806
10.551	Food Stamps	344,117,592 a
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children	81,331,341
10.561	State Administrative Matching Grants for Food Stamp Program	27,065,228 a
10.766	Community Facilities Loans and Grants	50,144,498
14.117	Mortgage Insurance-Homes	92,092,533
14.182	Lower Income Housing Assistance Program – Section 8 New Construction/Substantial Rehabilitation	68,023,673 b
14.856	Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation	825,397 b
17.225	Unemployment Insurance	379,762,912
17.255	Workforce Investment Act	32,073,487
20.205	Highway Planning and Construction	511,179,709 f
64.114	Veterans Housing-Guaranteed and Insured Loans	8,155,705

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)

Identification of Major Programs Audited (Continued)

CFDA #	Program Title	Expenditures
66.458	Capitalization Grants for State Revolving Funds	8,600,211
66.468	Capitalization Grants for Drinking Water State Revolving Funds	6,774,653
84.032	Federal Family Education Loans	50,706,598 c
84.069	Leveraging Educational Assistance Partnership	516,502
84.203	Star Schools	319,719
93.558	Temporary Assistance for Needy Families	208,445,415
93.563	Child Support Enforcement	41,173,059
93.568	Low-Income Home Energy Assistance	27,484,242
93.575	Child Care and Development Block Grant	13,844,066 e
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund	20,261,345 e
93.658	Foster Care-Title IV-E	55,287,902
93.767	State Children’s Insurance Program	19,606,751
93.775	State Medicaid Fraud Control Units	1,108,577 d
93.777	State Survey and Certification of Health Care Providers and Suppliers	6,007,091 d
93.778	Medical Assistance Program	2,450,570,344 d
93.959	Block Grants for the Prevention and Treatment of Substance Abuse	18,572,755
Total Type A Programs Audited		<u>\$ 4,539,749,111</u>

The following is a list of Type B programs audited as major programs:

CFDA #	Program Title	Expenditures
10.568	Emergency Food Assistance Program (Administrative Costs)	\$ 817,017 h
10.569	Emergency Food Assistance Program (Food Commodities)	5,159,418 h
14.235	Supportive Housing Program	3,061,926
15.605	Sport Fish Restoration	3,092,971 g
15.611	Wildlife Restoration	2,394,579 g
17.245	Trade Adjustment Assistance-Workers	9,160,937
17.246	Employment and Training Assistance - Dislocated Workers	281,309 i

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)

Identification of Major Programs Audited (Continued)

17.250	Job Training Partnership Act	1,052,203 i
17.253	Welfare-to-Work Grants to States and Localities	8,077,388
20.509	Formula Grants for Other Than Urbanized Areas	5,424,884
84.002	Adult Education – State Grant program	5,998,433
93.268	Immunization Grants	13,679,847
93.994	Maternal and Child Health Services Block Grant to the States	13,223,264
		<hr/>
Total Type B Programs Audited		<u>\$ 71,424,176</u>
Total Major Programs Audited		<u>\$ 4,611,173,287</u>

Identified clusters include:

- a – Food Stamp Cluster (Cabinet for Families and Children)
- b – Section 8 Project-Based Cluster (Kentucky Housing Corporation)
- c – Student Financial Aid Cluster (Kentucky Higher Education Assistance Authority, Kentucky Higher Education Student Loan Corporation)
- d – Medicaid Cluster (Cabinet for Health Services)
- e – Child Care Cluster (Cabinet for Families and Children)
- f – Highway Planning and Construction Cluster (Transportation Cabinet)
- g – Fish and Wildlife Cluster (Department of Fish and Wildlife Resources)
- h – Emergency Food Assistance Cluster (Department of Agriculture)
- i – Job Training Partnership Act Cluster (Cabinet for Workforce Development)

Dollar Threshold Used to Distinguish Between Type A and Type B Programs

The maximum dollar threshold used to distinguish between Type A and Type B Programs was \$15,000,000. Certain component units and agencies audited by CPA firms had lower dollar thresholds.

Auditee Risk

The Commonwealth did not qualify as a low-risk auditee.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

***Reportable Conditions Relating to Internal Controls and/or Reportable
Instances of Noncompliance:***

**FINDING 01-CFC1-1: The Cabinet For Families And Children Should Improve
Local Area Network Server Security And Consistently Apply Policies To All Servers**

State Agency: Cabinet for Families and Children

The Cabinet for Families and Children (CFC) should improve security of its local area network servers. Additionally, CFC should consistently apply security policies to all its NT servers.

We reviewed the security for specific servers that were identified within CFC's CFCOTSNT domain. The technical support staff in the Office of Technology Services manages this domain. Using general scanning tools, we queried the domain to identify all Primary Domain Controllers, Backup Domain Controllers, and Structured Query Language servers. We then reviewed information divulged on specific servers in this domain to determine the established password policies and specific services that might be available on these systems.

Upon review of the password policies identified, we determined that the administrative password policies established were not consistently followed. Additionally, a vulnerability scan was performed on these servers that identified security issues concerning the available web server software and file transfer protocol (FTP) services running on the systems. It was noted that some versions of the web server software could allow a remote attacker to run commands on a web server remotely and gain control of the computer. Also, older versions of FTP software were identified, which could allow attackers to remotely initiate a denial of service condition.

To help ensure the security of a network, it is necessary for a strong password policy to be developed and implemented on all servers within the network. If servers within a network are not sufficiently secured, the network could be compromised through one of these more vulnerable paths. To ensure adequate security, all software should be kept updated.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

**FINDING 01-CFC1-1: The Cabinet For Families And Children Should Improve
Local Area Network Server Security And Consistently Apply Policies To All Servers
(Continued)**

Recommendation

We recommend CFC review all servers within the agency-owned domains to ensure the password policy established on all servers complies with the guidelines specified by the agency. Further, we suggest that all services active on CFC servers be reviewed to ensure the most recent upgrades and/or patches have been installed.

Management's Response and Corrective Action Plan

[Network Management Branch] NMB-Workstation We are in the process of implementing an enterprise wide password policy requiring monthly changes to user passwords. We are also in the beta phase of implementing a new ghost image across the enterprise. Security and workstation control policies as well as a consistent local administrator account for each workstation will be implemented with our new ghost image. Pilot sites will begin 3/4/02 with the remainder of the State to be completed by late summer or early fall.

NMB-Server We are in the process of changing the passwords on ALL service and administrator accounts. The list of these Domain administrator and service account passwords is maintained in a secure directory within an encrypted file (128 bit). Only 4 NMB staff members and the NMB Branch Manager have access to the directory and the key to the file. The service accounts that your initial scans found as not changing in very long increments in time are being phased out. We have created parallel service accounts and are building our new ghost images with the new service account names and passwords. Once we have canvassed the state with the ghost we will disable the old accounts. Work is ongoing in these areas. Completion will follow the ghosting rollout.

NMB-Services Vulnerabilities We are working on identifying all open services that exist on our network. Once we compile that list we will be securing those areas as well. Work in this area is ongoing. We hope to have all unnecessary services identified within the next few weeks and will take controlled action as quickly as possible once the risks are identified.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC1-2: The Office Of Financial Management Should Improve Daily Monitoring Of The Sweep Amounts

State Agency: Finance and Administration Cabinet

The Office of Financial Management (OFM) implements investment policy, procedures, investment strategy, and handles the day-to-day investment decisions of the Commonwealth. OFM uses two methods for purchasing investment instruments to earn income from surplus cash:

- Overnight Investing – repurchase agreements are bought using an estimation process of available funds from the previous day, adjusted with other daily activity, that may cause wide fluctuations in the exact amount available to invest. In some cases, the estimates of amounts available to invest may exceed what is actually available at the time of investment. When this occurs, the state borrows funds, through a bank agreement to cover over-investments, and is required to pay interest that would have been earned if adequate funds had been available.
- Transfers To Sweep – any residual amounts remaining from the overnight investing process are “swept” at the end of the day and are invested in instruments at lower rates. In some cases, the amount available to “sweep” could be significant if the estimations for overnight investing are inaccurate.

OFM over-invested in total for the fiscal year. We reviewed the two-week sweep reports and the amount swept fluctuated greatly during FY 01. We realize the nature of the overnight investment results in OFM estimating the amounts available for investment; however, more accurate predictions should be possible.

In March 2001, OFM changed procedures related to the sweep account by investing in money market accounts. The amount in these accounts can be increased or decreased until late afternoon on any given day. This should enable OFM to have more control over the fluctuations in the sweeps. However, we noted fluctuation problems after March. Upon further investigation, it appears the problem relates to internal transfers.

The state could earn additional interest by better estimating the overnight investments and ensuring only a small amount left in the bank account for the sweep.

Good internal controls dictate that procedures should ensure the most accurate investment amounts possible for the overnight investments to reduce the likelihood of over-investing.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC1-2: The Office Of Financial Management Should Improve Daily Monitoring Of The Sweep Amounts (Continued)

Recommendation

We recommend OFM improve daily monitoring of the sweep amounts and money market account to reduce the fluctuations in the sweep amounts and earn greater interest for the state. Generating a daily report of internal transfers should enable OFM to make better predictions of the amount of money to place in or withdraw from the money market fund at the end of the day. If unanticipated fluctuations continue to occur, additional investigation should be made to determine reasons.

Management's Response and Corrective Action Plan

The process by which OFM determines the amount of investments needed in any given day used to be a two step process that we understood would discover the vast majority of disbursements and receipts for that given day. OFM would check with both the general depository bank and also with the state Treasurer in order to determine these transactions.

After it was brought to our attention that there were in fact very large disbursements that neither the general depository bank nor the Treasurer's office were aware of we in fact did some additional investigating. What we have found out is that there was an issue with ACH [Automated Clearing House] disbursements between MARS and the general depository bank. If an ACH was entered into MARS late in the day, the Treasurer does not become aware of the disbursement. The processing area at general depository bank was not notifying the head of the investment department at the general depository bank who would let us know about the disbursement.

This problem has been rectified. Division of Accounts is now allowing OFM to run a MARS report that tells us if there are any late day ACH's. OFM has been running this report for several months and we have not had a large sweep balance in that time.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC2-3: The Finance And Administration Cabinet Should Improve Controls Over Preparation Of The Cash And Investment Note

State Agency: Finance and Administration Cabinet

The Finance and Administration Cabinet (FAC) CAFR team prepares the cash and investments note (Note 5). The CAFR team uses a confirmation database to compile summary sheets for each component unit of the Commonwealth. The confirmation database includes MARS account numbers, funds, agency numbers, cash balances, cash on hand, book values for short-term and long-term investments, and market values for short-term and long-term investments. Confirmation letters providing component unit investment information per FAC's records are sent to each component unit upon request. The summary sheets for each component unit provide cash and investments classifications and categorizations. In reviewing Note 5 information for each component unit, some problems were noted in the following areas: classification, categorization, confirmation letters, and reconciliation.

Classification

In reviewing the summary sheets prepared by FAC, some classification errors were noted. For example, the state investment pool funds were not handled consistently between cash and investments classifications. FAC reported the state investment pool funds in two different ways. Sometimes state investment pool cash and investments were reported as a total under investments. Other times, the state investment pool cash was reported as cash on the summary sheet, and the state investment pool investments were reported as a separate line item under investments. The state investment pool cash should be shown in the cash section of the summary sheet, and the investments should be shown in the investments section of the summary sheet.

Also, some funds were not classified as the correct type of investment. For example, money market funds were classified as mutual funds in error.

Improper classification could cause the Note 5 cash and investment balances to be overstated/understated. For example, the cash for Kentucky Educational Television (KET) was counted twice. Also, KET has money market funds, which were incorrectly classified as mutual funds in Note 5.

According to the Implementation Guide for Government Accounting Standards Board (GASB) 9, Footnote 5, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*,

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC2-3: The Finance And Administration Cabinet Should Improve Controls Over Preparation Of The Cash And Investment Note (Continued)

[C]ash includes cash on hand and demand deposits with banks or financial institutions. Cash also includes deposits in other kinds of accounts or cash management pools that have the general characteristics of demand deposit account . . . A demand deposit account is one in which a government may deposit additional cash at any time and also withdraw cash at any time without prior notice or penalty. . . .

In relation to this issue, question 15 of the Implementation Guide states, “the equity in an internal cash investment pool should not be considered cash unless the funds can be withdrawn at any time without prior notice or penalty”

Moreover, question 15 notes for cash flow reporting purpose, the equity in a pool that is sufficiently liquid to enable withdrawal without prior notice or penalty should be treated as cash, and otherwise the equity should be considered an investment. The Commonwealth’s investment pool is sufficiently liquid to be treated as cash.

Categorization

In reviewing the summary sheets prepared by FAC, some categorization errors were noted. For example, an investment was put in the incorrect category (category 3 instead of 2) on the summary sheet, when compared to the Annual Financial Report (AFR) form (shows funds held or not held by the state treasury).

Improper categorization could cause Note 5 cash and/or investments to be overstated/understated, which could mislead the reader in understanding the credit risk for a particular investment. For example, the Kentucky Center for the Arts’ summary sheet shows category 3 money market funds, which should be reported under category 2 per the audited balance sheet. Also, the Kentucky Center for the Arts’ summary sheet shows category 3 mutual funds, which should be reported under category 2.

According to GASB 3 Implementation Guide for GASB 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, Question 4, provides there are three credit risk categories used to report cash and investments information depending on “who the securities custodian is and how the securities custodian holds the security.”

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC2-3: The Finance And Administration Cabinet Should Improve Controls Over Preparation Of The Cash And Investment Note (Continued)

The categories required for reporting are as follows:

1. The custodian is the government's agent and is not the counterparty or the counterparty financial institution's trust department. The custodian holds the securities in the government's name.
2. The custodian is the counterparty financial institution's trust department or the counterparty's agent and the custodian holds the securities in the government's name.
3. The custodian is the counterparty, regardless of whether it holds the securities in government's name.

OR The custodian is the counterparty financial institution's trust department or the counterparty's agent and the custodian does not hold the securities in the government's name.

If the investment is not insured or registered or if collateral or investment is not in the possession of the government, then the investment is required to be categorized in one of the above categories.

Confirmation Letters

In the Note 5 preparation process, confirmation letters are sent to agencies and CPA firms. For FY 01, the confirmation letters were only sent upon request. Copies of the letters sent were kept in a file; however, a log of requests was not maintained.

Confirmation letters sent only per request by the agency and CPA firm cannot be reliably tracked without an updated log to document the request. Confirmation letters provide component unit information per FAC's records. Differences between the agency records and FAC records may exist and not be discovered, since only agencies requesting confirmation letters receive them.

Good internal controls dictate confirmation letters be sent to each agency requesting information for Note 5 for the CAFR to ensure confirmations are performed in a timely and reasonable manner. On the other hand, if confirmation letters are only sent upon request, a log should be kept for agencies requesting a confirmation letter, including person making request, date of request, and date letter was sent.

**COMMONWEALTH OF KENTUCKY
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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC2-3: The Finance And Administration Cabinet Should Improve Controls Over Preparation Of The Cash And Investment Note (Continued)

Reconciliation

The FAC CAFR team, in preparing Note 5, did not reconcile the AFR 126b form (State Investment Pool Funds) to the confirmation database for some component units. Also, the audited balance sheet was not agreed to the AFR 126a form (Funds Not Held by State) and 126b forms. In comparing the confirmation database to the AFR 126b form, some differences were noted. Upon inquiry, some of these differences were not investigated by FAC.

Errors can remain undetected when the AFR form and the balance sheet are not reconciled.

Good internal control dictates the reconciliation of AFR forms to the balance sheet and the confirmation database. The reconciliation process ensures the accurate reporting of cash and investments for Note 5.

Recommendation

Classification

We recommend proper classification of state investment pool cash as cash on the summary sheet, and state investment pool investments as investments on the summary sheet in accordance with GASB standards.

Categorization

We recommend consistent and proper categorization of investments be done for each agency for Note 5 as required by GASB 3.

Confirmation Letters

We recommend FAC maintain a complete log of requests for confirmation letters by agency, or simply send confirmation letters to all agencies and CPA firms.

Reconciliation

We recommend FAC perform reconciliations for AFR forms to the balance sheet and confirmation database for each component unit for Note 5, and investigate

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC2-3: The Finance And Administration Cabinet Should Improve Controls Over Preparation Of The Cash And Investment Note (Continued)

Recommendation (Continued)

any differences to improve the accuracy of Note 5. Also, we recommend FAC provide training and instructions to the component units to improve the accuracy of the AFR 126b forms, which should greatly improve the accuracy of classifications and categorizations and the reconciliation process.

Management's Response and Corrective Action Plan

CLASSIFICATION – FAC needs to be more consistent in how the State Investment Pool is classified. The problem arose when two individuals using different methodologies prepared the NOTE 5 worksheets. We agree with your recommendation. Pooled cash will be properly classified as cash and the pooled investments will be properly classified as investments.

CONFIRMATION LETTERS –FAC does not feel that confirmation letters should be sent to all agencies. Sending confirmation letters to all agencies is not needed, only the component units for which we rely on audited CPA reports. We agree with your recommendation and a log of requests will be maintained for all requests for confirmation letters.

RECONCILIATIONS – Reconciliations of AFR forms to Balance Sheets were performed, however, not documented. Several component units sent in AFR forms for cash and investments, both inside the state system and outside the state system, that did not total back to reported balance sheet amounts. KET is an example. FAC therefore reviewed the Note disclosures in the audited financial reports (both prior year and current year) to determine proper classification and categorization. FAC agrees with your recommendation to provide clearer instructions to the AFR forms. This would greatly improve the accuracy of classification and categorization of investments.

CATEGORIZATION – AFR forms were not properly prepared forcing FAC to review current year and prior year audited financials to determine classification and categorization. As stated above, FAC should provide clearer instructions to the AFR forms to improve the accuracy of classification and categorization of investments.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC3-4: The Office Of Financial Management Should Improve Control Procedures Over Modifications To System Programs

State Agency: Finance and Administration Cabinet

OFM has not developed and implemented formalized policies and procedures for control of program modifications for batch programs that feed into the Complete Asset Management, Reporting, and Accounting system (CAMRA) that is used to process Commonwealth investments. The CAMRA software is purchased from an external vendor. Our prior two audits have revealed that OFM has several critical batch programs that provide data to CAMRA, as well as providing data from CAMRA to MARS. These batch programs are maintained by OFM. Formal policies and procedures have not been developed or implemented to ensure all program modification requests are documented, monitored, tested, and properly approved prior to being placed into production. Additionally, all OFM investment employees have full access to CAMRA related batch programs.

In the past, the CAMRA-related batch programs were ACCESS and EXCEL macro programs that were maintained by one OFM employee. Some documentation was placed within the programs to describe the process. Otherwise, there was very little other documentation on the various batch programs. The employee that developed most of these programs left the employment of OFM in February 2000. No documentation was developed to ensure that OFM management or any subsequent employees would have adequate descriptions of objectives for the various programs or how they should be processed.

All of these batch programs, spreadsheets, and macros are scheduled to be replaced in FY 02 by new programs that are being written in the Statistical Analysis System language by an OFM employee. Those programs are being tested by OFM prior to implementation and extensive documentation and descriptions are being developed for these programs. Additionally, user and operator guides are being drafted for these programs, as well as program modification control policies. However, these guides and policies were not formalized at the time of our audit fieldwork.

Formalized program modification policies and procedures are needed to ensure consistent procedures are followed for authorization and approval of program changes, development of technical and user documentation, training of users, requirements for testing, tracking of requests, transfer of changes into production, and maintenance of an audit trail for program changes. Without formalized controls over program modifications, management increases the risk that incorrect or unauthorized changes could be moved into production that would adversely affect system processing. Also, without a formally documented

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC3-4: The Office Of Financial Management Should Improve Control Procedures Over Modifications To System Programs (Continued)

process for tracking program modifications, it would be difficult for OFM to know the status of requested changes. Further, adequate system documentation is needed to ensure OFM management, as well as current and future employees, are aware of the programmed processes in place. Finally, employees should only be provided system access to programs and data that is necessary for the completion of their assigned duties.

Recommendation

We recommend OFM management ensure development and implementation of formal written program modification control policies. The policies and resulting established procedures should address the following issues:

- Tracking of program change requests and completion.
- Testing requirements and authorization and approval of changes.
- Technical and user documentation.
- Control of program transfers to production.
- Further restricted access to CAMRA-related programs within the OFM Investment group.
- User training.

Management's Response and Corrective Action Plan

OFM will put into place a program that tracks any changes made to the new software package in place. Formal documentation will be affected once we are current with our new system. Documentation is being created as the program is being developed but the decision was made that bringing the system up to current date was of first concern.

OFM has hired an employee who has over twenty-five years of training and experience in programming and documentation of those programs. We will use his expertise along with any suggestions the Auditor of Public Accounts would like to make to insure proper documentation and controls are in place.

The new programs being developed will only be accessible by two people in OFM. At this point in time we only have one person trained in the language [Statistical Analysis System] . . . but intend to train a backup.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC4-5: The Office Of Financial Management Should Improve Security Of Its Servers

State Agency: Finance and Administration Cabinet

OFM should improve security for its New Technology (NT) servers including the primary server that contains the CAMRA system used to process Commonwealth investments. Although OFM has made significant improvements in logical security since the prior audit, the CAMRA server and its backup server are still located outside the FAC OTS' environmentally controlled and secured operations room and are not currently configured for firewall protection.

Discussions revealed that OFM and OTS are currently awaiting implementation of a new version of the CAMRA program prior to migration of these servers to the OTS environment. This is expected to occur early during calendar year 2002.

Layers of logical and physical access controls should be provided to protect the agency computing resources against unauthorized use or modification, damage or loss. Critical computing resources should be located within an environmentally controlled and secured operations room. Any resources accessible from the internet in any fashion should be further protected by the use of firewalls or intrusion detection devices.

Recommendation

We recommend OFM work in conjunction with OTS to ensure the CAMRA server and its backup server are relocated as soon as possible within the OTS secured operations room once the new CAMRA program is implemented. OFM should take the steps necessary to ensure that this migration occurs within the next few months.

Management's Response and Corrective Action Plan

OFM is working as quickly as possible to migrate to the new CAMRA version. We expect by March 1, 2002 that we will be using the new version. At that point we will move the CAMRA server and its backup server into the Finance Office of Technology Service's environmentally controlled and secured operations room.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC5-6: Catalog Of Federal Domestic Assistance Numbers Were Improperly Coded In MARS

State Agency: Finance and Administration Cabinet

A review of projects in the MARS Advantage system found CFDA numbers were being incorrectly coded. The Federal Domestic Assistance Catalog Division (FDAC) compiles and maintains those CFDA numbers that are currently valid. The CFDA number in the Advantage environment is a project's Federal Catalog Agency and Federal Catalog Number combination. A review of all projects within Advantage that have CFDA numbers against the CFDA Listing of All Catalog Programs revealed 78 projects, or 21.4% of the population, with Federal Catalog Agency/Number combinations that were not valid.

A contributing factor to the establishment of inaccurate CFDA numbers was that under the current version of the Advantage module, the Federal Catalog Number field would allow a four-digit, alphanumeric value. A valid Federal Catalog Number, however, is a three-digit, numeric value. Because of this lack of appropriate restriction on field input, there were 54 projects, or 14.8% of the population, with Federal Catalog Numbers that did not conform to the expected length of three characters. Also, there were 39 projects, or 10.7% of the population, with Federal Catalog Numbers that used alphanumeric characters.

Through additional testing to ensure the accuracy of the liability claims for both federal and state interest, the auditors were able to see no effects on the Cash Management Improvement Act (CMIA) reporting for FY 01 due to inaccurate CFDA coding. However, the potential exists for the occurrence of inaccurate CFDA recording that could adversely affect the CMIA reporting in the future.

For CFDA reporting to be accurate, the information used to develop the reports must be complete and accurate. Therefore, it is imperative that all projects are routinely reviewed to ascertain that any CFDA numbers used are valid. It is ultimately the responsibility of FAC to ensure Advantage data is accurately input allowing reports to be generated correctly.

Recommendation

We recommend FAC begin reviewing all projects periodically to ensure that associated Federal Catalog Agency/Number combinations are valid according to the FDAC CFDA listing. Further, the Federal Catalog Number field requirements within Advantage should be changed to restrict input to three numeric characters.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC5-6: Catalog Of Federal Domestic Assistance Numbers Were Improperly Coded In MARS (Continued)

Management's Response and Corrective Action Plan

All formatting discrepancies were solved outside the system before the queries to generate the calculation were executed. No projects were missed due to a CFDA number formatting error. We will consider placing edits on the field input relative to the volume of corrections that have to be made.

Auditor's Reply

The majority of projects that use CFDA numbers within MARS are not reportable to the CMIA. Discrepancies with CFDA numbers may have been “solved outside the system” before the creation of the CMIA Annual Report, but that cannot be indisputably stated for all reports or calculations that are being created within the agencies. The use of the recommended edits and review process would significantly decrease the number of CFDA numbers that could be missed through a query due to the formatting. At a minimum, FAC should notify agencies of the problem and instruct them on the importance of using appropriate CFDA numbers.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC6-7: The Office Of Technology Services Should Improve Security Of The Servers Within The Local Area Networks For Finance And Administration Cabinet

State Agency: Finance and Administration Cabinet

OTS did not adequately establish proper security for its MS Windows NT and 2000 servers. The primary domain controller maintains the Dynamic Host Configuration Protocol server and the backup domain controller houses the Remedy Action Request system for helpdesk management. Vulnerabilities were noted that could affect the security of all servers across the FAC domain. These weaknesses were noted as a result of our audit procedures to examine threats and vulnerabilities for these servers and data devices processing on FAC's Local Area Network (LAN). Although there was no evidence noted of any security breaches during our review, the following vulnerabilities were noted:

- A security policy statement to address security procedures has not been developed and/or made available to users of the LAN in FAC.
- The user account policy for the FAC domain is not adequate to properly secure the logical access for system users. Password restrictions should be strengthened by:
 - enforcing a maximum password age to cause frequent password change.
 - requiring a minimum password length with character variety.
 - keeping password history to force password turnover.
- There are no formal procedures in place, nor does documented authorization exist to justify system user's access to computing resources on the LAN.
- Employees are encouraged, but are not required, to use automatic screensavers that would provide an automatic logoff feature for their PC if they leave their workstation for any length of time.
- Configurations of services were not established in such a way as to provide adequate security of the primary, backup and internet information server (IIS). All servers should be scanned to identify unnecessary open ports to substantiate the available services.
- Procedures for recording security violations are not formally documented nor protected from accidental or intentional destruction during the audit period.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC6-7: The Office Of Technology Services Should Improve Security Of The Servers Within The Local Area Networks For Finance And Administration Cabinet (Continued)

The NT Network Monitor utility previously provided useful diagnostics, but has been disabled due to conflicts with a specific server in the network.

The FAC domain is managed by five (5) system administrators, including the Chief Information Security Officer (CISO). Subsequent to the audit period, another system administrator was added to assist in managing the security issues. OTS had taken some significant measures to protect information resources. The security administrators for OTS had installed current service releases and security packs as of our fieldwork in August 2001. Current anti-virus software was also noted on the primary network devices.

As of September 14, 2001, most of the weaknesses noted were discussed with the CISO in OTS and certain procedures have already been implemented by FAC, in coordination with vulnerability assessments, to remedy the noted weaknesses. It is our understanding that the OTS will complete the draft security policy and make it available to all system users in the FAC domain. Even though these remedies were implemented after the audit period under review, we would like to recognize FAC's willingness to address noted weaknesses timely.

Recommendation

We recommend OTS continue to work in conjunction with FAC management to ensure actions are completed to provide adequate security for the MS Windows NT and 2000 servers, and any related processing devices, within the FAC domain. This effort should include procedures to:

- Review all user accounts for appropriate password age and implement a policy to force all users to change passwords regularly. The policy should require all passwords to be changed frequently and tested for vulnerability on a regular basis.
- Document all users that have been granted access to information system resources and establish procedures for authorizing users with the appropriate system access.
- Establish procedures that adequately address the steps to handle network intrusion detection and ensure proper measures are in place to remedy.
- Ensure systems will automatically logoff when not in use for a reasonable time period.

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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC6-7: The Office Of Technology Services Should Improve Security Of The Servers Within The Local Area Networks For Finance And Administration Cabinet (Continued)

Recommendation (Continued)

- Ensure configurations of services maintained on OTS controlled servers are such as to provide optimum security.
- Complete development and implementation of adequate policies and procedures concerning network intrusion detection proceedings concerning the FAC domain.

Management's Response and Corrective Action Plan

1. *Review all user accounts for appropriate password age and implement a policy to force all users to change passwords regularly. The policy should require all passwords to be changed frequently and tested for vulnerability on a regular basis.*

While this is an appropriate and straightforward recommendation it is complicated by a mission critical application that is hosted by Finance, Office of Technology Services (OTS). The application is "Registrar" and is used by all Commonwealth agencies to schedule Governmental Service Center (GSC) training.

In order for Finance to grant someone access to Registrar, OTS must create a Finance domain user-id that mimics the user-id that exists at the user's home agency. Experience has shown that network users typically have difficulty maintaining synchronized user account information across multiple network domains and regularly lock out their user accounts.

Currently Registrar has a user population of approximately 230. OTS believes that implementing the recommended password security would significantly impact GSC scheduling and reporting across the Commonwealth.

Currently OTS and GSC are working with Registrar support contacts to implement an architectural change to the Registrar system. The desired solution would allow Finance to implement the recommended password security controls without impacting the usage of the Registrar application. Finance is making every effort to move forward on this project and it is believed that the APA password security recommendations will be effective by June 30, 2002.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC6-7: The Office Of Technology Services Should Improve Security Of The Servers Within The Local Area Networks For Finance And Administration Cabinet (Continued)

Management's Response and Corrective Action Plan (Continued)

2. *Document all users that have been granted access to Information System resources and establish procedures for authorizing users with the appropriate system access.*

Finance OTS has reviewed current security assignments and access to network resources to ensure that security assignments are appropriate. As of January 1, 2002, a form or email from the appropriate manager will be required for granting of network permissions to cabinet employees. A copy of the request form or email will be retained for future reference.

3. *Establish procedures that adequately address the steps to handle network intrusion detection and ensure proper measures are in place to remedy.*

OTS has implemented Black Ice intruder detection software. This software allows host-based network monitoring and is configured to notify the OTS Security Officer and technical support staff of suspicious network activity. Finance cabinet users are instructed be on alert for suspicious network activity and report any concerns to Technology Services for proper handling. The procedures include the documentation of the incidents and informing of the cabinet CIO. Further assistance will be requested from GOT [Governor's Office for Technology] Security Services where appropriate. Finance OTS has incident response procedures in place modeled after those followed by GOT Security Services.

4. *Ensure systems will automatically logoff when not in use for a reasonable time period.*

After discussing this item with APA audit staff for clarification our understanding of the recommendation is that all Finance computers be configured to use a screen saver with the password option enabled. This configuration would essentially lock the computer after a specified amount of idle time and would require the entry of the password to unlock the computer. OTS has now directed all Finance computer users to use a screen saver with the password option enabled. As an additional step, OTS is implementing software that will enable us to monitor the use of screen savers and force compliance through automated administration if necessary.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC6-7: The Office Of Technology Services Should Improve Security Of The Servers Within The Local Area Networks For Finance And Administration Cabinet (Continued)

Management's Response and Corrective Action Plan (Continued)

5. *Ensure configurations of services maintained on OTS controlled servers are such as to provide optimum security.*

OTS has made significant progress in this area. We expect to have all file server reconfiguration complete prior to June 30, 2002.

6. *Complete development and implementation of adequate policies and procedures concerning network intrusion detection proceedings concerning the Finance domain.*

Security incidents are recorded in F012 forms and, if appropriate, forwarded to GOT. Files are stored on secure network resources and backed up nightly.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC7-8: The Finance And Administration Cabinet Should Implement Policies And Procedures To Ensure Compliance With Applicable Small Or Small Minority Set-Aside Laws

State Agency: Finance and Administration Cabinet

In FY 99, the APA reported that policies and procedures relating to Small or Minority Business Set-Aside Laws were not implemented. Our audit follow-up to this comment for FY 00 determined that no action had been taken. In response to this finding, management responded that a disparity study was a necessary measure for implementing set-aside laws. The study was to be released February 2001 and no later than March 2001. The disparity study has yet to be completed.

Based on the Commissioner's response to the FY 99 comment, FAC had decided not to implement small minority business set-asides based on *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989) (USSC+). Based on the court's decision in this case, FAC had contracted for a \$696,000 contract for a "disparity study" in order to document any discrimination in the awarding of state contracts. FAC maintains that a study of this sort is necessary in order for the Commonwealth to actualize the laws. The regulation and the statutes were created after the court case. KRS 45A.675 was modified July 15, 1998. Based on this order of occurrence, it is difficult to pinpoint a causal relationship between the court's findings and FAC's decision not to implement the laws. Thus, our finding for the current fiscal year is the Cabinet has failed to comply with the applicable KRS sections relating to Small or Minority Business Set-Asides.

Recommendation

We recommend FAC create and implement policies and procedures to ensure compliance with the applicable statutes. Alternatively, if FAC does not feel compelled to comply with this statute, we recommend it fully document reasons why it has not complied with these laws. If necessary, we recommend that FAC request an opinion from the Kentucky Attorney General's Office concerning its decision not to implement the small or small minority business set-aside laws.

**COMMONWEALTH OF KENTUCKY
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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-FAC7-8: The Finance And Administration Cabinet Should Implement Policies And Procedures To Ensure Compliance With Applicable Small Or Small Minority Set-Aside Laws (Continued)

Management's Response and Corrective Action Plan

The Disparity Study has not been finalized at this time. It is anticipated that the Study will be complete in the near future. The Finance and Administration still maintains that, in accordance City of Richmond v. J.A. Croson Co., 488 U.S. 469 (1989) (USSC+), a Disparity Study is necessary in order to establish the predicate upon which remedies such as the Small and Small Minority Business Set-Aside, can be implemented.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-GOT1-9: The Governor’s Office For Technology Should Improve The Application Development Control Structure For The Client/Server Applications On The UNIX Or Windows NT Operating Systems

State Agency: The Governor’s Office for Technology

The application development control structure at GOT for the mainframe environment appears to be well designed and has been in place for a number of years. The application development control structure for the client/server applications, those systems developed on a UNIX or Windows NT operating system, is not as mature as the mainframe environment. We recognize that management of this area is aware of this fact and has made several improvements in the design of this complex control structure. An example of these improvements is the revision of the Systems Life Cycle Manual (SLCM) to include more formal procedures for development and maintenance of Windows NT and UNIX applications. One weakness noted during our review was the ability of two individuals, identified as senior programmers, to access the production libraries for The Workers Information System (TWIST) application.

Further, as an example, on the Kentucky Child Care Management System (KCCMS) there are three main groups that are used for file permissions “prog,” “dba,” and “usr.” Three main user accounts are used to restrict access: “kydev” for development, “kytrain” for training, and “kypod” for production. The three main user accounts along with many others are members of all three groups. This means that people from the development department could access and change files in the training or production directories.

Our review included the following tests:

- Inspected a judgmental sample of program executables from the production directories with a last modified date between January 1, 2001 and June 30, 2001 and verified that the SLCM was followed, and supporting documentation was properly completed.
- Inspected SLCM to determine whether it outlines that certain deliverables are required for change requests.
- Inquired of Project Management to determine that appropriate implementation procedures are used for UNIX/Windows NT program changes.
- Inspected a judgmental sample of UNIX/Windows NT implementations.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-GOT1-9: The Governor's Office For Technology Should Improve The Application Development Control Structure For The Client/Server Applications On The UNIX Or Windows NT Operating Systems (Continued)

Recommendation

We encourage GOT management to continue to update and refine the SLCM and develop a controlled environment for Windows NT and UNIX applications that is similar to the environment for the mainframe.

Management's Response and Corrective Action Plan

GOT concurs that the control structure for the Unix or Windows NT environments are not as mature or well-defined as that associated with the Mainframe environment. In response, the GOT development process control points for the Unix/NT environments have been updated and will be implemented on or before September 1, 2001. Three different scenarios are included:

- GOT development staff moves the executable code/web pages to a staging library and the customer moves the code to a production library, to which GOT staff have no access.*
- GOT development staff moves the executable code/web pages to a staging library, the customer approves the application move to production, and GOT production staff moves the code to a production library, to which GOT development staff have no access.*
- GOT development staff move the executable code/web pages to a staging library, the customer approves the application move to production, and different members of the GOT development staff moves the code to a production library. This is the least desirable approach and will only be implemented when the agency chooses to host their servers and the agency is without internal production support.*

The specific deficiencies found and documented in the management letter were oversights and have been corrected. Management oversight has been strengthened to prevent further such occurrences.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS1-10: Custom Data Processing, Inc. Should Improve System Security Controls For Cabinet For Health Services Data

State Agency: Cabinet for Health Services

Review of controls established by Custom Data Processing, Inc. (CDP) to provide reasonable assurance that logical access to the Cabinet for Health Services (CHS) related programs and data is limited to properly authorized individuals revealed that the controls were not suitably designed based on the following findings:

- Application servers are logged in under a shared administrator account. While the servers are locked with a screen saver password, several employees, including programmers, know the screen saver password.
- Text logs are extracted from system logs generated from the application servers. Operations management and personnel review the text logs daily. Users may modify the text logs with administrator level access on the application servers.
- CDP's two internet connections (one in Frankfort, Kentucky and one in La Grange, Illinois) are using proxy software as the only method to protect CDP resources from internet attacks. CDP also has a publicly accessible web server that allows web users to directly connect to the CDP internal network.
- The Windows NT Security Account Manager, a file that contains all user accounts and password information, is not encrypted.
- Management could not confirm that the Front End Processor (FEP) user account file, that contains all user accounts and password information, is encrypted. In addition, management could not confirm that the transmission of clear text FEP user passwords over the network.

Recommendation

CDP should improve procedures to prevent unauthorized or undetected access to information resources.

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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS1-10: Custom Data Processing, Inc. Should Improve System Security Controls For Cabinet For Health Services Data (Continued)

Management's Response and Corrective Action Plan

- *The current system design requires the application servers to be logged into under a shared administrator account. To continue to provide the level of service contracted with CHS, certain programmers must know the password to access these systems in the event a fatal flaw or bug is encountered during the nightly update. CDP will explore other alternatives for running the application programs and where possible will implement additional levels of security. We will also attempt to further limit programmers' access to these servers.*
- *CDP will investigate and where possible implement additional levels of security that will assure that unauthorized changing of the text log files cannot occur. Until this is implemented, CDP will begin a process whereby the Operations staff runs a program to print out the text logfile and the operator will attest to its status and content at that point in time.*
- *CDP has installed a Sonic Wall firewall on its Internet connections*
- *CDP will investigate encrypting this file.*
- *CDP will investigate how to encrypt these passwords as they traverse the network.*

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS2-11: The Department For Public Health Should Complete A Formal Information System Security Policy

State Agency: Cabinet for Health Services

As noted during the previous four (4) audits, the Department for Public Health (DPH) did not provide adequate security for the Local Health Network that governs the Women, Infants, and Children (WIC) System. The following weaknesses were reported last year and remain unresolved for FY 01:

- Initial Request for Access: There was no formal system access request policy in place.
- CDP Reports: No violation or attempted unauthorized system access reports were received from CDP for review.

Our examination revealed that the DPH still does not have a formal access request policy in place. The security administrator refers to a letter issued to users dated September 17, 1999 detailing the access procedures currently in place as policy. However, this has not been incorporated into the formal security policy. Failure to document existing policies could lead to a lack of understanding by management and users, and result in noncompliance with security policy for areas such as the issuing, deleting, and/or sharing of user IDs.

Additionally, we tested a sample of 42 CHS user requests for mainframe access and found that 17, or 41%, were missing one (1) or more required authorizing signatures. Further, we tested 11 access requests for WIC access and found that eight (8) of those users did not have request forms on file. Discussions revealed a review was done in January 2000 of user requests with access to WIC. The WIC security administrator at CHS had reviewed the access levels provided to WIC users and had made several adjustments for certain users, and had even deleted the access for some IDs. However, it was found that those users who had obtained access and signed the Local Health Network Security Request Form prior to January 2000 do not have request forms on file. It appears these forms may have been discarded.

Finally, our examination also revealed that DPH does not receive any violation or attempted unauthorized system access reports from CDP, and it does not have established formal procedures to contend with unauthorized network intrusions.

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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS2-11: The Department For Public Health Should Complete A Formal Information System Security Policy (Continued)

The appropriateness of user access to systems cannot be ensured without a properly approved system access request. Documentation should be available to verify proper authorization of the system access granted. Further, users that are granted the minimum access necessary to complete their jobs indicate a strong security environment. Finally, uniform application of formal and documented security policies and procedures provides continuity for policy implementation as well as sets the tone of management concern for a strong system to secure assets and resources. These policies and procedures provide a security framework to educate management and users of their responsibilities. Failure to comply with security policies could lead to interruption of processing or other services, unauthorized data or program modification, and destruction of assets.

Recommendation

We recommend the following additional steps be taken by DPH to strengthen security for the Local Health Network:

- Initial Request for Access: (a). Develop detailed written policies to establish standards for system security. Also, develop procedures to be followed by the security administrator and system users including procedures for requesting system access. (b). All users with access to WIC that do not have signed and approved Local Health Network Security Request Forms on file should be requested to complete an updated form.
- CDP Reports: Establish formal procedures for contending with unauthorized intrusions to the WIC network. These procedures should include steps for requesting reports from CDP containing unauthorized system access attempts.

Management's Response and Corrective Action Plan

The following comments are provided in response to computer security:

There are several different components to DPH computer security. We have provided the auditors with relevant memos to demonstrate activity with regard to computer security. We do agree that all processes and procedures need to be brought together in one document. We have hired an information technology (IT) person to write an IT Operations Guide. This guide will bring those components together. A copy will be provided to your office when completed. Estimated completion date is April 30, 2002.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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SECTION 2 – FINANCIAL STATEMENT FINDINGS

**FINDING 01-CHS2-11: The Department For Public Health Should Complete A
Formal Information System Security Policy (Continued)**

Management's Response and Corrective Action Plan (Continued)

The WIC Program uses the department's security access process. Procedures are attached. There are additional layers to the Local Health Network but the front door access is secured through the department's password assignment process. (A diagram was provided to the auditors) The Administrative Policy and Procedures Manual for Local Health Departments (pages 2 and 3) of the Patient and Community Health Services Reporting and Billing Procedures Section addresses security clearance and assigning passwords for local health departments. Additionally, we were provided with a list of WIC Program staff that supposedly did not have proper access to the WIC system. There were seven such people on the WIC Program staff. All of these employees were cited as not having proper access in the prior audit. The authorization was signed on January 21, 2000, by the Administrative Section Supervisor of the Food Delivery/Data Section.

The portion of your audit relating to mainframe security is not a DPH responsibility. This responsibility resides in the Office of Program Support, Technology Resources Management Branch of our Cabinet. A copy of the RCW [Record of Control Weakness] was forwarded to their work group.

It is my understanding that CDP does have formal procedures for detecting and dealing with unauthorized intrusions. We agree that a coordinated, documented procedure of notification to DPH is needed and will be accomplished. A copy will be provided when completed. Estimated completion date is April 30, 2002.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS3-12: The Financial Management And Reporting Branch Should Limit Access To Deposits

State Agency: Cabinet for Health Services

Receipts from various divisions within CHS, including the Vital Statistics Branch, are delivered to the Financial Management and Reporting Branch (FMRB) daily. Upon delivery all checks are stamped with a transmittal number for tracking purposes. The cash is recounted, and monies are secured in the safe. All receipts that FMRB processes are put into the same deposit bag within the safe. This process occurs many times throughout the day.

FMRB has six (6) people with access to the safe. All six (6) people also could potentially have access to the deposit bag. Access to the safe is neither limited nor recorded.

The Vital Statistics Branch deposit is usually the only one containing cash. It is the first deposit processed each day. Throughout the day, up to six (6) people place deposits into the same deposit bag, which has the cash. Thus, the potential for loss or theft is greatly increased if there are not any controls over access to the safe and deposits.

Recommendation

We recommend that the Vital Statistics Branch deposit be secured in a different deposit bag than other agency receipts.

Management's Response and Corrective Action Plan

The Financial Management and Reporting Branch within the Cabinet for Health Services has reviewed this record of control weakness and the recommendation. As of October 24, 2001 the use of a separate deposit bag for Vital Statistics deposits has been implemented.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS4-13: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Job Duties

State Agency: Cabinet for Health Services

The Vital Statistics Branch issues birth, death, marriage, and divorce certificates. They collect receipts by walk-in, mail, and phone requests. Due to two (2) cases of fraud last year, the APA decided to give closer attention to the Vital Statistics Branch. We visited the agency on three (3) separate occasions and noticed the following control weaknesses:

- 1) As we noted in a previous audit, the auditor observed the prior day receipts being taken out of the safe for deposit preparation. Once the deposit was prepared, the entire deposit was left unattended long enough for someone to take the receipts.
- 2) Requested certificates are printed on watermarked documents. Some of these certificates are pre-numbered and some are not. The branch does not have a document custodian who has the exact count of blank certificates on hand. There is no logbook of any kind showing the certificates used, voided, or missing.
- 3) Openings in the front and rear of the office are accessible to anyone in the building.
- 4) Current practices for receipts are not adequate to achieve proper control over them. Receipts are not issued to walk-ins who pay fees in cash. Checks received by mail are not restrictively endorsed at the earliest possible point. Receipts are not reconciled to a receipts logbook after posted, by batch or by the day. One (1) flextime employee stays 15 minutes longer than the other employees. During this time, all unopened correspondence is left in the unlocked file cabinet and this employee is responsible for locking the cabinet.
- 5) The branch issues death certificates to funeral homes by way of prepaid vouchers. The vouchers are easily counterfeited. The person who receives the prepaid money and posts it, also controls the issuance of the voucher.
- 6) Each morning the safe is unlocked for distribution of non-processed requests, deposit preparation, and whatever cash is left from the previous day. In addition, a clerk is issued a key to a cabinet containing signed blank checks. The safe is left unlocked and unattended all day with an average of \$15,000 receipts inside.
- 7) The key issued from the safe unlocks a cabinet located in the front of the office, and is unlocked each morning by the clerk. The cabinet is left unlocked until the end of the day. The cabinet contains a stack of signed blank checks, which is easily accessible by anyone who walks by the cabinet.
- 8) Data Entry Operators have assigned user IDs and passwords. The passwords have not been changed in over two (2) years, and on some occasions, more than one (1) operator shares user IDs. Three (3) people have a complete list of the user IDs and passwords.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS4-13: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Job Duties (Continued)

Recommendation

We recommend the following:

- 1) The Vital Statistics Branch should provide better physical security over receipts.
- 2) The branch should use only pre-numbered certificates and assign someone to keep track of the pre-numbered certificates.
- 3) Install a door at each entrance, and these two doors should lock as they are shut. Only branch personnel should have access to this area.
- 4) (a) The branch should lock all funds in a secure location before the employees leave each day. The flextime employees should not have access to the receipts when no one else is present. (b) Restrictively endorse checks when the mail is opened or received at the front desk. Once endorsed, all checks and cash should be recorded in a receipts logbook for mailed in receipts or by entering the transaction in the cash register. (c) When receiving cash from walk-ins, a pre-numbered cash receipt (manual or numbered cash register receipt) should be issued. The cash register tape or the manual cash receipts should be batched and reconciled to the cash register reconciliation sheet. The money deposited each day should be reconciled back to the operator cash reconciliation sheets and to the cash receipts issued logbook or equivalent record.
- 5) The branch should print prepaid vouchers on a security type of pre-numbered paper. The branch should assign one employee to be in charge of receiving the prepaid money, and segregate the duty of issuing the vouchers to another employee.
- 6) The safe should be locked when not in use.
- 7) The signed blank checks should be accounted for two (2) or three (3) times a week and locked in the safe during the day.
- 8) (a) Passwords should be changed immediately. This process should continue on a regular basis every 30 to 90 days. Operators should choose their own password. Two (2) operators should not ever share user IDs and passwords. Passwords should be kept confidential. (b) Vital Statistics Branch should have the Accountant III perform either the end of day reconciliation or the deposit preparation, but not perform both tasks.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS4-13: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Job Duties (Continued)

Management's Response and Corrective Action Plan

CHS provided the corresponding responses:

- 1) Effective October 20, 2001, when the accountant responsible for preparing the daily deposit leaves the desk (for any reason) while preparing the deposit, the deposit receipts will be locked, by the employee, in the desk until employee returns.*
- 2) All on-line security paper currently is pre-numbered. This paper is used to print certified copies of all birth certificates from 1961 to present (after being key punched). The long form security paper, used for all death, marriage, divorce, births prior to 1961, and new births prior to being keyed, is not pre-numbered. On the next reorder of this paper, we will request to have it pre-numbered for tracking purposes and will track the same as we track the on-line paper.*

In August 2001, the Administrative Section Supervisor of the Certification Section was assigned to track the use of security paper in the Vital Statistics Office on first floor of the Human Resources Building. The paper, in its original sealed, numbered boxes, is kept in a locked room in the Vital Statistics Vault area in the basement of the building. The supervisor of the Vault Unit is responsible for the security of the paper while in his unit. The Section Supervisor calls down for security paper when it is needed for printers and copiers on the first floor. The requested number of sealed boxes is sent up from the vault where the supervisor logs the date, box numbers and beginning numbers ending numbers of the on-line paper. The supervisor will issue on-line paper to the 4 printers and record beginning and ending numbers. At the end of each day the unused on-line paper returned to the supervisor will be logged into the logbook also by numbers. The number of "VOID" certificates will be logged and subtracted from the number of certificates printed along with the unused paper. This can also be done with the long form paper after receiving the new order, which will be pre-numbered for tracking purposes. Effective November 1, 2001, the Vault Supervisor will also log the date, number of boxes, the box number and the numbers on the on-line paper when it is sent up to the first floor.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS4-13: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Job Duties (Continued)

Management's Response and Corrective Action Plan (Continued)

"Void" stamps are being purchased and upon receipt, every certified copy of a certificate printed and not of sufficient quality to be issued to a customer will be stamped "VOID" and will be handed over to supervisors several times a day for tracking. At the end of every week after being logged on a daily basis these voided certificates will be shredded. Presently, "VOID" is being written on the printed certificate when it is inadequate for issuance to the customer.

Personnel in the Office of the Secretary, Cabinet for Health Services has contacted several other state Vital Statistics offices concerning procedures for tracking security paper. All these will be taken into consideration.

As of October 1, 2001, all employees work between the hours of 8:00 AM and 4:30 PM.

The office is investigating the possibility of adding counters to Lexmark Printers so actual number of on-line birth certificates printed can be counted each day, this will add another security feature to the auditing of on-line security paper. The copy machines have counters but will not suffice as a tracking method. Security paper is used in one tray and regular paper is used in a second tray. This is necessary for the printing of death certificates since verifications of a death certificate are printed on pink paper as the certified copies are printed on security paper, The vendor has been contacted, there is no way just to count the paper going through a single tray.

- 3) The Human Resource Building is owned by the Commonwealth of Kentucky and managed by Facilities Management within the Finance and Administration Cabinet. The Cabinet for Health Services is a tenant in the building. Structural changes are made at the discretion of the Finance and Administration Cabinet. This building was designed for flexibility in that stationary walls do not divide offices. Offices are established with mobile wall panels. Also there are multiple agencies housed within the complex. Within the past year, security of the entire building has been enhanced significantly with the requirement of an ID badge that is read through a card reader at employee entrances.*

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS4-13: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Job Duties (Continued)

Management's Response and Corrective Action Plan (Continued)

The Vital Statistics office has installed ropes, with signs attached stating "RESTRICTED AREA" across all open entrances into the office. Staff have been instructed to monitor the area for any unauthorized entry. The Cabinet is also looking into the feasibility of video security for the Vital Statistics Office. Effective October 18, 2001 the outgoing mail trays were moved from near the rear exit of the office to a centralized location in the view of the Administrative Section Supervisor of the Certification Section and the Fee Control Unit Supervisor.

- 4) *Effective October 1, 2001, flex time prior to 8:00 AM and after 4:30 PM has been discontinued. All receipts and security paper are locked in the safe between 4:30 PM and 8:00 AM the next morning.*

Within a six-month period of time all mail openers in the Fee Control Unit will be trained to do data entry and all data entry operators will be trained on the procedures of how to open and direct mail to the other units. The procedure will then be for each employee of the Fee Control Unit to open a piece of mail, immediately restrictively endorse the check or money order, date and code the check or money order, date and code the correspondence, and then enter the data on the DEC VAX computer (this is an older computer which is no longer made) for an audit trail prior to opening another piece of mail. This procedure should suffice for an immediate audit trail for each piece of correspondence. Hence the individual daily reports would be reconciled back to the operator who opened the correspondence, endorsed the check, and then entered the data on the VAX. There would be 8 or 9 smaller deposits to reconcile rather than 4 or 5 larger ones, which should also make it easier for the accountant to reconcile daily reports. When the new Vital Statistics Information System (VSIS) is implemented in late 2003, this is basically the way it will work (all mail openers and data entry operators will be 1 in the same) plus an electronic daily log will be automatic. One possible problem may arise if this solution causes the processing of the mail to slow down, if so, other measures will need to be taken. This office is mandated by law to issue

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS4-13: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Job Duties (Continued)

Management's Response and Corrective Action Plan (Continued)

certified copies of death certificates within two days if they are requested at the time of the filing of the original certificate with this office. This is already difficult at times with the present process.

Additional cash registers are being purchased for the Front Desk clerks. We expect to have them in place by January 1, 2002. Each clerk taking in checks and cash will be responsible for only their register. Each register tape will be matched daily to the cash reconciliation sheet. There will make for smaller individual reports batched from the Front Desk, which should be easier to reconcile than one larger one. Smaller reports will also tell us if, and which, employee is having trouble with entering receipts in the cash register. As with the employees in the Fee Control Unit, the procedure will be for each employee who receives an, application and the fee, to immediately restrictively endorse the check or money order, date and code the check or money order, date and code the application and then enter the data on the VAX for an audit trail prior to accepting another application from a customer.

- 5) The State Registrar is in the process of purchasing pre-numbered impede security paper to use for pre-paid vouchers. The security paper is expected to be in place by January 1, 2002. A log is presently being set up on the Fee Control Unit Supervisor's personal computer using Office Excel software. The supervisor will log in dates and voucher numbers distributed to funeral homes and record the used voucher number and date upon receipt back in the Vital Statistics Office. A data entry operator has always had the responsibility of receiving the prepaid money and the Fee Control Unit Supervisor has issued the vouchers to the funeral homes. We will continue to stamp the raised seal that states "Commonwealth of Kentucky Vital Statistics" on each voucher.*

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS4-13: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Job Duties (Continued)

Management's Response and Corrective Action Plan (Continued)

- 6) *Effective November 1, 2001, the Fee Control Unit safe will be locked at all times, except when it is necessary to remove items from or return items to the safe during work hours.*
- 7) *Effective August 27, 2001, the Administrative Section Supervisor of the Certification Section was assigned to ensure blank Vital Chek checks were accounted for properly. All these special purpose blank checks are kept in a locked safe at all times. At the end of each day the supervisor gives each Vital Check operator a check to be printed for that day. The printed checks are then returned to the supervisor to store in the safe until the daily deposit is prepared the following day.*
- 8) *Effective November 1, 2001, data entry operators will change passwords for the user ID assigned to them on a regular basis, the 1st of every other month (approximately every 60 days). Operators will choose their own passwords and not share with other employees.*

Effective November 16, 2001 the Accountant III will be responsible for the end of day reconciliation and the Accountant I will perform the preparation of the daily deposit. Training will be required for backup personnel.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS5-14: The Vital Statistics Branch Should Perform An Accurate Cash Reconciliation

State Agency: Cabinet for Health Services

The Vital Statistics Branch issues birth certificates, death certificates, marriage certificates, and divorce certificates for fees ranging from \$6 to \$10. The requests for these documents come into the branch through mail, phone, and walk-in applications. Each operator submits an individual batch report detailing the day's transactions.

On the following day, the branch's Accountant III runs a total batch report and prepares the deposit to be sent to the FMRB. If the deposit does not match the report, the Accountant III must go over the individual batch reports to locate errors. If errors cannot be located and corrected, the department has a petty cash amount kept in the safe made up of state funds for these types of occurrences. State funds are used to correct the deposits. The petty cash has a balance, which is not to exceed \$100. If the petty cash becomes low on state funds, any overages on future dates are taken from the daily deposit and added to the current total. If the petty cash has a branch acceptable amount on hand, when a deposit has any overages, these overages are added into the deposit under the report heading of "Miscellaneous."

We noted several areas where a cash reconciliation sheet was not prepared at closeout. Furthermore, even when a cash reconciliation sheet was prepared the overages and shortages were not accurately reported due to the use of the petty cash amount.

Recommendation

We recommend that no government funds be set aside for petty cash. The amount currently in the petty cash should be deposited immediately. Furthermore, each person handling funds should prepare an accurate cash reconciliation at closeout.

Management's Response and Corrective Action Plan

Vital Statistics has taken steps to assure that deposits received will be deposited as collected, and no overage/underage account will be used.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS6-15: The Vital Statistics Branch Should Take Steps To Prevent Identity Theft

State Agency: Cabinet for Health Services

Kentucky birth certificates are easy to obtain from the Vital Statistics Branch (Vital Statistics), and can be used to get a passport and other identification documents. Obtaining a birth certificate is often one of the first steps in perpetrating an identity theft.

Kentucky death certificates are also easy to obtain and show the deceased's social security number. Having the social security number of a recently deceased person could result in credit cards being issued in the deceased's name. This is an example of identity theft. Two (2) supervisors and two (2) managers at Vital Statistics stated that they recognize this risk and would like to see this matter corrected.

Identity theft could be facilitated by the ease with which vital records, such as birth and death certificates, can be obtained.

Proper internal control dictates that Vital Statistics not release:

- data which is excluded from disclosure by law, and
- data which could easily facilitate identity theft or other crimes.

Most states are more restrictive on providing vital statistics information than Kentucky. Vital Statistics personnel have indicated their desire to meet the national norms in this area.

When KRS 213.011(14) and KRS 213.131(1) are read together, it is clear that vital records should not be open for inspection or publicly released except where specifically authorized by law. KRS 213.131(1) further states, "[a]dministrative regulations adopted by the cabinet shall provide for adequate standards of security and confidentiality of vital records. . . ." Title 901, Chapter 5 of the Kentucky Administrative Regulations addresses vital statistics, but these regulations do not address adequate standards of security and confidentiality of vital records.

Recommendation

We recommend:

- CHS promulgate administrative regulations as noted in KRS 213.131(1) to address adequate standards of security and confidentiality of vital records;

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS6-15: The Vital Statistics Branch Should Take Steps To Prevent Identity Theft (Continued)

Recommendation (Continued)

- Appropriate steps be taken to prevent disclosure of vital records data that could be misused by those seeking to commit identity theft; and
- Legislation be proposed and enacted to strengthen the security of confidential vital records data, similar to the legislation already enacted in most other states.

Management's Response and Corrective Action Plan

*KRS 213.131(1) does state, "To protect the integrity of vital records, to insure their proper use ... it shall be unlawful ... to issue a copy", but this section then states "except as authorized by this chapter." KRS 213.136(1) must be followed and this statute states in pertinent part, "The state registrar **shall** upon receipt of an application issue a certified copy of a vital record in the registrar's custody or a part thereof to **any** applicant." Although KRS 61.878(1) (a) excludes public records that would constitute an unwarranted invasion of personal privacy, the Attorney General has issued opinions 81-400 and 82-234 concerning the disclosure of information within vital statistics records. OAG 82-234 states that on a birth certificate only medical information and the mother's home address are considered private information and the name cannot be redacted. OAG 81-400 states "There are no privacy rights involved in a request to inspect death records since the exemption provided by KRS 61.878(1)(a) pertains only to "personal privacy", and that term only applies to the living." Accordingly, in order to possibly avoid the facilitation of identity theft, the statutes noted above would need to be amended to exclude vital records. Presently, only 13 states (including Kentucky) have open birth records and 19 states (including Kentucky) have open death records.*

Auditor's Reply

We believe that the disclosure of social security numbers and other confidential vital records data is contrary to the intent of the Kentucky General Assembly. We strongly encourage CHS to promptly seek passage of legislation clarifying and strengthening the law in this area.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-LAB4-16: The Labor Cabinet’s Division Of Administration Should Ensure Assets Are Safeguarded Within The Special Fund

State Agency: Labor Cabinet, Special Fund

Appropriate internal control procedures require safeguarding assets such as property and equipment. Safeguarding such assets includes maintaining an inventory list and conducting periodic inventories to ensure that assets detailed on the listing are in existence.

The Special Fund maintains inventory listings that include identification tag numbers. During the audit, employees were asked to produce a piece of computer equipment with a specific tag number. The equipment produced had no tag attached and was a different model than the equipment on the listing.

Special Fund personnel explained the equipment that originally had the ID number had been retired and replaced by the equipment presented. The new equipment was to have the same ID number but a tag had not been attached yet.

Lack of accurate inventory listings could result in inaccurate accounting records and/or misappropriation of state-owned property.

Recommendation

We recommend that the Special Fund periodically review inventory listings and determine that all property detailed on the listing is in existence. We also recommend that tags and ID numbers not be reissued to replacement equipment. Retired equipment should be deleted from inventory listings.

Management’s Response and Corrective Action Plan

It is our position that Special Fund property is adequately protected by the Labor Cabinet’s long-standing written property inventory policy. Our policy requires that all property with an original cost of \$500 or greater be inventoried through issuance of a property identification tag (placed over an engraved property number) and maintenance of a detailed inventory listing which describes the property and its location. Annual inventories must be conducted by the Cabinet’s property officer who personally views all inventoried property to ensure that it exists. The policy meets all applicable legal requirements for state owned property and requires the property officer to have the ability to report, upon request, all items over \$500 to the Fixed Assets Branch, Finance and

**COMMONWEALTH OF KENTUCKY
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FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

**FINDING 01-LAB4-16: The Labor Cabinet’s Division Of Administration Should
Ensure Assets Are Safeguarded Within The Special Fund (Continued)**

Management’s Response and Corrective Action Plan (Continued)

Administration Cabinet. Finally, our policy provides that directors and managers are responsible for maintaining control of all items under their jurisdiction, regardless of the original cost of the property.

To resolve this audit issue, the property officer has engraved and tagged a property number on the subject laptop computer. Moreover, the Labor Cabinet will emphasize to appropriate staff the need to follow the Cabinet’s written inventory policy, which requires an annual review of inventory listings, and personal viewing of the property to ensure the property is in existence. Additionally, emphasis will be placed on the need to issue new property numbers and tags for all property costing \$500 or more, including replacement property, and the importance of promptly deleting all retired property from inventory listings.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-PERS1-17: The Personnel Cabinet Should Improve Security Controls For Uniform Payroll And Personnel System Logical Access

State Agency: Personnel Cabinet

The Personnel Cabinet (Personnel) did not provide adequate logical security controls for access to the Uniform Payroll and Personnel System (UPPS). Despite our prior recommendations to limit access of GOT programmers to Personnel production load libraries, data files, and Job Control Language (JCL), our review specifically noted the following:

- Five (5) GOT programmers had update or control access via Time-Sharing Option (TSO) to production JCL and various datasets.
- One (1) of these GOT programmers also has update access to the Personnel Security files. This access gives them the ability to grant any users access to Personnel programs, JCL, or datasets. We understand Personnel uses the GOT programmer as a backup security administrator.

We also noted the Computer Security Policy/Procedure Manual (security policy) implemented by Personnel has not been updated since June of 1997. As we had recommended in our prior audit, changes made to the Security List form during last year need to be reflected in security policy, and thorough procedures for completing the form should be included. We had also recommended that instructions would be useful to explain the different levels of security access available and detail specific filing or retention policies of the Security List forms. Additionally, the current security policy does not include network intrusion detection proceedings.

Update access to the Personnel load libraries, production data, and security files should be restricted to Personnel staff only. Failure to maintain proper segregation of duties for GOT programmers increases the likelihood that an unauthorized change is possible to programs, JCL, or data. A strong control environment would not allow programmers access without adequate authorization and oversight. Circumstances of an emergency nature requiring update access privileges should be documented and closely monitored at the appropriate supervisory level. For those circumstances when it is necessary to grant update access to an application program, JCL, and/or dataset, a log should be created that specifically identifies the individual accessing the system by user ID, time of entry into the system, specific programs and data accessed, and purpose. All activity should be subject to supervisory control and system log entries should be substantiated by a formal request to make system changes or modify system access privileges.

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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-PERS1-17: The Personnel Cabinet Should Improve Security Controls For Uniform Payroll And Personnel System Logical Access (Continued)

Finally, formal security policies and procedures provide continuity for policy implementation as well as set the tone of management concern for a strong system to secure assets and resources. These policies and procedures should be kept current as they provide a security framework to educate management and users of their responsibilities.

Recommendation

We recommend Personnel take the following steps to improve logical security of UPPS:

- Eliminate all update and control accesses for GOT programmers. These employees should not have access to production data and/or JCL except in specific cases. Any update or control access granted to programmers should be documented and monitored closely by Personnel management. In addition, update access should be restricted to the level required to perform the assignment for a set time period and then rescinded. We recommend someone other than a GOT programmer be chosen as a backup security administrator.
- Update accordingly, and review periodically, the Personnel Cabinet Security Policy/Procedure Manual. The manual should include some general procedures concerning proceedings to identify and contend with unauthorized network intrusions.

Management Response and Corrective Action Plan

The Personnel Cabinet is currently mandated to maintain the official records of all state employees. It is further mandated to generate accurate and timely payroll tapes to ensure that all state employees are paid promptly on the 15th and 30th of each month.

The current statewide payroll/personnel system was implemented in 1982 and is an old mainframe COBOL system that has limited workflow. The system requires significant programming hours to ensure normal maintenance. All updates to the system have to be completed with the assistance of programmers from the Governor's Office of Technology, who have the sole expertise to make the necessary changes to the programs and/or data sets.

**COMMONWEALTH OF KENTUCKY
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

**FINDING 01-PERS1-17: The Personnel Cabinet Should Improve Security Controls
For Uniform Payroll And Personnel System Logical Access (Continued)**

Management Response and Corrective Action Plan (Continued)

The Personnel Cabinet requires that all individuals having access to the system sign a security agreement before access is granted. This access creates an adequate audit trail of all users through the creation of a system log which specifically identifies the individual users by user ID, time of entry into the system and the specific program or data accessed during the entry to the system. This log is created and reviewed on a monthly basis.

As a result of the previous audit reports regarding adequate logical security controls, the Personnel Cabinet has recently established a Resource Management Analyst II position in the Department for Personnel Administration, Division of Employee Records, that will have primary responsibility for both internal and external access to the system. This position will work closely with agency liaisons and the Governor's Office of Technology staff in an effort to implement recommended security controls. This position will also be responsible for maintaining and updating the Computer Security Policy/Procedure Manual that was created in 1997.

The following specific exceptions to security controls are addressed as follows:

- *Five (5) GOT programmers had update or control access via Time Sharing Option (TSO) to production job control language and various datasets.*

The Personnel Cabinet has addressed this issue, in that access to those programmers has been rescinded until such time as they actually require access. Upon request for access, the security officer will grant that access on a time limited basis and again rescind access as appropriate.

- *One of these GOT programmers also has update access to the Personnel Security files.*

This update access has been eliminated. While this programmer will still need update capability at times, this is another area that the new security officer will control by granting and rescinding access on an as needed basis.

**COMMONWEALTH OF KENTUCKY
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-REV1-18: The Revenue Cabinet Should Update The Sales Tax Database And Automate Processing Of Accelerated Tax Returns

State Agency: Kentucky Revenue Cabinet

We requested an Electronic Funds Transfer (EFT) report from the Revenue Cabinet's (Revenue) Department of Information Technology, Office of Application Engineering detailing all tax payments that equaled or exceeded \$1,000,000 during FY 01; the report had 207 payments that met our criteria. We then selected all items we deemed as individually significant for the General Fund. We identified and tested 12 sales tax returns that met our criteria, totaling \$154,767,855 in tax payments. During testing, we noted the following problems:

- The Revenue sales tax database does not process payments that equal or exceed \$1,000,000, thus a single transaction exceeding \$1,000,000 will show up on the Revenue mainframe report as 999,999 in a succession of lines with the bottom line total as the balancing amount. While this is a system limitation, data processed in this manner is difficult for end users to understand.
- Significant clerical errors were found in the manual processing of accelerated sales tax returns that were not detected and corrected by the existing internal control structure. We noted a clerical error, in one month's tax return, resulting in a \$4,545,738 overstatement of the taxpayer's pre-payment. The second instance resulted in a \$3,000,623 overstatement of the taxpayer's pre-payment. All accelerated sales tax returns are manually processed in the sales tax section, since the Modernized Front End (MFE) is not set up to process these returns. The accelerated taxpayers make a pre-payment of sales tax each month of an estimated 50% of the next month's tax payment.

During FY 01, Revenue automated the processing of its high volume sales and use and withholding tax returns through the MFE. The MFE is used for scanning tax returns for posting to the Revenue Cabinet's mainframe, depositing receipts, and imaging returns for archiving purposes. Revenue users with access to the FileNet System are able to view images of all items in a transaction that are scanned into the MFE.

While FY 01 financial statement information was not affected as a result of these weaknesses and errors, the system limitation could affect the accuracy and reliability of the Revenue reporting system. Tax information that is not captured exactly as reported on the tax return makes it difficult to determine if receipts were recorded at the proper amounts. Also, since the tax information is difficult to track, the likelihood that errors will go undetected by Revenue increases.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-REV1-18: The Revenue Cabinet Should Update The Sales Tax Database And Automate Processing Of Accelerated Tax Returns (Continued)

The system weaknesses, noted herein, represent deficiencies in the design and operation of internal controls that could result in violations of laws and regulations which would materially affect Revenue's financial reporting. Good internal controls dictate receipts should be properly posted to computer records from supporting documentation and all data processed by significant systems should have the proper review and audit to determine accuracy and completeness.

Recommendation

We recommend Revenue take the following actions to correct these weaknesses:

- Make the appropriate adjustments to correct the affected reports and accounts;
- Update Revenue's mainframe system to process tax payments that equal or exceed \$1,000,000; and,
- Program the MFE to process all accelerated sales tax returns; this would reduce manual processing and should increase mathematical accuracy, which would increase the reliability of the mainframe data. If this isn't feasible, due to the magnitude of the tax payments involved, all accelerated sales tax returns should have a secondary level of review that includes verifying, editing, and approving all adjustments.

Management's Response and Corrective Action Plan

The Kentucky Revenue Cabinet (KRC) agrees with the auditor's recommendation regarding the correction of the clerical errors. The appropriate adjustments are currently in the process of being corrected by a Sales Tax Section unit supervisor. The clerical errors noted by the auditor resulted from one employee temporarily assigned to the Sales Tax accelerated program from another taxing area. That employee assisted in the accelerated returns for a short time to help alleviate a sizable number of unworked returns. That situation has now been corrected so that the inventory has been greatly reduced to a more manageable level, and, only 2 to 3 experienced Sales Tax employees, under the direct supervision of an experienced Sales Tax unit supervisor, now work the accelerated sales tax returns.

Regarding the recommendation to update the Revenue mainframe system, to process payments that equal or exceed \$1,000,000, the Cabinet concurs. The sales tax system is approximately 25 years old and is due for a major overhaul.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-REV1-18: The Revenue Cabinet Should Update The Sales Tax Database And Automate Processing Of Accelerated Tax Returns (Continued)

Management's Response and Corrective Action Plan (Continued)

The Cabinet previously considered replacing or extensively overhauling the system. However, the cost to replace the system is prohibitive at this time. Additionally, there are national discussions regarding a uniform sales tax base and rate. The outcome of the national debate regarding the future of sales tax could be applicable to Kentucky in the very near future. Without knowing the outcome of those discussions, Kentucky can not proceed with major system changes at this point in time.

The Kentucky Revenue Cabinet (KRC) agrees that processing Accelerated Sales Tax returns on the MFE would reduce manual processing and increase mathematical accuracy, which would increase the reliability of mainframe data. Programming to allow such processing should be completed during the MFE restructuring, which is scheduled to be implemented in July 2002. For those Accelerated Sales Tax returns processed manually at Revenue Operations, a TAD is created which is subsequently worked by Compliance. It should be noted that the process of creating TAD's on all accelerated returns does create a "secondary level of review" conducted after the initial processing of the return.

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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-REV3-19: The Revenue Cabinet Should Have A System In Place To Reconcile Critical Information

State Agency: Kentucky Revenue Cabinet

Revenue does not have a system in place to input or reconcile critical information to the mainframe system; this continues to be a problem for Revenue as this has been reported during prior year audits as well. By not performing critical reconciliations, Revenue cannot be sure that reported amounts remitted are correct. While Revenue currently has a reconciliation project underway, which is now in the detail system design phase, there was no system in place at the time of our audit.

Revenue should have adequate systems in place to ensure all taxes due to Kentucky have been collected and all taxpayers are reporting key information in compliance with state laws.

Recommendation

Revenue should develop a system for reconciling critical information.

Management's Response and Corrective Action Plan

The Kentucky Revenue Cabinet (KRC) agrees with the Auditor's recommendation. KRC initiated a plan during fiscal year 2001 to correct this problem. Past Auditor's comments have addressed this problem and KRC searched several years for an affordable method of addressing the issue. The new reconciliation system is expected to go live on April 1, 2002.

Auditor Reply

The new reconciliation system did not go live on April 1, 2002 as expected. However, the project is now being conducted in phases. Phase I is complete and Phase II is expected to be complete by June 12, 2002. We urge KRC to correct this deficiency as soon as possible.

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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-KST1-20: The Department Of Treasury Should Notify The Office Of Financial Management In Writing Prior To Applying Multiple Approvals

State Agency: Office of the Kentucky State Treasurer

When testing 43 cash receipt documents (C1) for proper approval by Treasury, we found that three (3) were not properly approved. The OFM employee entering the C1 applied one (1) approval, as required; however, the three (3) other necessary approvals were applied by a Treasury employee. In the cash receipt approval process for investments, the OFM employee entering the C1 applies one (1) approval, a manager in OFM applies two (2) additional approvals, and Treasury applies the final approval. Since the Treasury employee who approved these transactions had the authority to apply four (4) approvals, the document was processed without the approval of the OFM manager.

The FAC's Administrative Policy and Procedure Manual is in draft form and not complete on the approval process for C1s relating to investments.

The OFM manager might notice errors relating to investments that a Treasury employee would not notice due to lack of expertise in the investment area. OFM secondary approvers cannot check the C1s for accuracy after Treasury approves them if they are not notified Treasury applied three (3) approval levels to the C1. In addition, since the Treasury employee has four approval levels, the Treasury employee could create and approve a C1 without anyone else approving or knowing about the document.

Good internal controls dictate a standard approval process for investment cash receipt documents be implemented and followed. The standard approval process should not allow a final approver to apply the same approval levels applied by a secondary approver, in effect overriding the approval of the secondary approver, unless the secondary approver is given written notice (e-mail for example) that the document will be or was approved by the final approver.

Section 4.3 of the draft of the FAC's Administrative Policy and Procedure manual states:

OFMEA will be responsible for the creation of all payment, receipt, etc. documents relating to the investment of state funds. The Treasurer's office, which currently prepares these documents, will now be responsible only for applying an approval on cash receipt documents relating to investment of state funds. . . . Agency will prepare **C1** document to record the receipt of funds from one of the following:

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-KST1-20: The Department Of Treasury Should Notify The Office Of Financial Management In Writing Prior To Applying Multiple Approvals (Continued)

- Sale of Investment
- Maturity of Investment
- Interest Income

The **BS Account** must be coded on the **C1** document. Route the document to the Division of Statewide Accounting Services for approval. .
.. The Division of Accounts approves the **C1** documents and routes the ones pertaining to the investment of state funds (OFMEA) to the Treasurer's Office for their approval.

At present, the Division of Accounts does not apply any approvals to the C1 documents

Recommendation

We recommend adjusting the approval levels of Treasury employees so no employee can create a cash receipt document and apply final approval to the document.

Also, OFM approvers should be notified in writing (e-mail) if Treasury approves a document without approvals being applied by a secondary person in OFM.

Relating to the Manual we recommend the FAC:

- Update the manual to indicate the secondary approval levels applied by the OFM manager, assistant director, or director.
- Either remove reference to the Division of Statewide Accounting approval of C1 documents or C1 documents should be routed to the Division for approval immediately.
- Define in detail the authorization of Treasury in approving documents without a secondary approver and refer to this when discussing investment documents.
- Release the manual in final form.

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-KST1-20: The Department Of Treasury Should Notify The Office Of Financial Management In Writing Prior To Applying Multiple Approvals (Continued)

Management Response and Corrective Action Plan

Finance and Administration Cabinet Response:

*The Treasurer's Office (Treasury) is the final approval for all cash receipts documents (CR and C1) in the Advantage Financial application. They apply the 4th level of approval to the C1 documents created by OFM to record the sale or maturity of investments or the receipt of interest income. Treasury does not approve the documents until they reach a **PEND4** status (after OFM has applied their approvals).*

There were a few instances where Treasury approved a C1 document before it reached PEND4 status. OFM reported this to the Office of the Controller. A meeting was held with representatives from the Treasurer's Office, OFM and the Controller's Office. Treasury agreed they would not approve the OFM C1 documents until it reached a PEND4 status. If, for some reason, there were a need to approve one in a status other than PEND4, Treasury would need to have a written (E-mail) authorization from OFM.

The few "non-PEND4" C1 documents that Treasury approved for OFM were done so because of "timing" problems. To help resolve this OFM and Treasury have been set up to use the Workflow functionality in Advantage. After the initial user in OFM creates the C1 (and applies the first approval) an E-mail is sent to the OFM Manager notifying him that there is a C1 document in PEND2 status awaiting his approval. At this point, the OFM Manager can go into Advantage and approve the document. This has decreased the "agency" processing time for C1 documents.

Treasury needs to have the authority to apply/remove all approval levels on cash receipts documents. It is Treasury's responsibility to see that the documents are accurately recorded in Advantage, which is why they have the final approval. At times it may be necessary for Treasury to correct a C1 document.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-KST1-20: The Department Of Treasury Should Notify The Office Of Financial Management In Writing Prior To Applying Multiple Approvals (Continued)

Management Response and Corrective Action Plan (Continued)

In Advantage, a partially approved document (Ex. PEND4 status) is always “read-only”. In order to make any changes to a document all the approvals have to be removed before the change(s) can be made. After the change is made all approvals have to be applied again. Treasury will notify the agency (who prepared the C1) if any changes need to be made. If possible, the agency will remove the approvals, correct the document, and apply the “agency” approvals again.

It may be necessary for Treasury to do this. If, for example, it is the last day of the calendar month/fiscal year and Treasury is not able to contact a user in the agency (who has entered a document incorrectly) to do this, they need to have the authority to change the document to make sure funds are recorded in the correct accounting period/fiscal year.

Office of the State Treasurer Response:

The Treasurer’s Office is the final approval for all C1 and CR documents. It is the Treasurer’s responsibility to make certain that the MARS deposit documents are in agreement with the amount being deposited, either electronically or by physical deposit. If there is an error, the Treasury Department contacts the department preparing the deposit document to make the needed correction. If the necessary individual in the departments cannot be reached, and if there is a deadline which has to be met, the Treasury Department personnel will make the corrections needed to allow the documents to be posted. They will then notify the departments of the changes. To make these necessary changes in a timely manner, it is absolutely essential that the Treasury Deposit Room and Accounting personnel have the necessary MARS authority to apply/remove all approval levels on cash receipt documents. The Treasurer’s Office does not exercise this approval authority except when absolutely necessary to allow deposits to post in a timely manner.

The first line of action is always to contact the departments preparing the deposit documents to have them make the corrections. If this fails, and a deadline has to be met, the Treasury will make the changes and give the necessary approvals.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-KST1-20: The Department of Treasury Should Notify the Office of Financial Management In Writing Prior To Applying Multiple Approvals (Continued)

Management Response and Corrective Action Plan (Continued)

There is no risk involved to the Commonwealth in this procedure. These are, after all, deposits and not expenditures. If an accounting error were to be made by the Treasury staff in making the corrections or releasing the documents, that error can be corrected after the fact. This possibility is far preferable to the alternative of not having deposits post in a timely manner, especially at those critical times when Revenue estimates and financial reports are depending on the deposit data.

**COMMONWEALTH OF KENTUCKY
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CWD1-21: The Division Of Unemployment Insurance Did Not Report Deferred Revenues

State Agency: Cabinet for Workforce Development

The agency did not report an amount for deferred revenue on the AFR-32, Revenue Recognition Recap form. Deferred revenues are employers' benefits received that will be paid in future periods.

In preparation of the Commonwealth's CAFR report, FAC recorded deferred revenue for the Cabinet for Workforce Development. However, if FAC did not properly record deferred revenue, then there would have been an overstatement of accounts receivable and an understatement of deferred revenue on the agency's closing package forms for Unemployment Compensation.

Proper internal controls dictate deferred revenue is properly classified as a liability for amount received, not earned as of June 30.

Recommendation

The agency should record deferred revenue from revenue earned not received as of June 30 to amount received not earned as of June 30 on the AFR-32, Revenue Recognition Recap form. To properly classify deferred revenue the agency should record any non-operating and/or other revenue over 30 days less the allowance for uncollectible amount in the deferred revenue column on the AFR-32 form.

Management's Response and Corrective Action Plan

The agency agrees with the auditors recommendation.

**COMMONWEALTH OF KENTUCKY
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CWD2-22: The Division Of Unemployment Insurance Allowance For Uncollectible Accounts Was Not Updated For Current Year Actions

State Agency: Cabinet for Workforce Development

The “Allowance for Uncollectible” for tax collections on the FAC AFR-30 and AFR-32 closing package forms was not changed from the prior year. The auditor spoke with the Unemployment Insurance (UI) Tax Branch Manager, who responded that due to staff shortages UI was unable to process any write-offs of delinquent accounts for tax collections.

When the “Allowance for Uncollectible” accounts is not written off, the accounts receivable balance tends to be overstated.

Proper accounting procedures dictate receivables be evaluated periodically to determine the likelihood of collection and an amount that is likely to not be collected be written off. KRS 341.300 (4) states:

an action for the recovery of contributions, interest or penalties under this section shall be barred and any lien therefore shall be cancelled and extinguished unless collected or suit for collection has been filed within five years from the due date of such contributions, except in the case of the filing of a false or fraudulent report the contributions due shall not be barred and may at any time be collected by the methods set out in this chapter, including action in a court of competent jurisdiction.

Recommendation

The agency should:

- establish a procedure to estimate a reasonable allowance for uncollectible accounts;
- age accounts so that accounts over five (5) years and not in litigation are written off in a timely manner; and
- implement procedures to ensure write-offs of uncollectibles are properly authorized.

Management’s Response and Corrective Action Plan

- *Previously this agency has given an estimated uncollectable allowance based on previous history of uncollectable writeoffs. The last estimate given was an average of 1996, 1997, and 1998 writeoffs. This figure was \$1,414,907 per*

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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SECTION 2 – FINANCIAL STATEMENT FINDINGS

**FINDING 01-CWD2-22: The Division Of Unemployment Insurance Allowance For
Uncollectible Accounts Was Not Updated For Current Year Actions (Continued)**

Management's Response and Corrective Action Plan (Continued)

year. Knowing that there are many factors that contribute to the receivable figure, such as rates, collection efforts, and economy this estimate is hard to secure unless we use previous history. We could possibly request additional programming to determine all accounts that appear to be uncollectable and then those that would age into that category within the next year. This kind of report should be available with the new KEWES [Kentucky Electronic Workplace for Employment Services] process described below.

- In the collection piece of KEWES there is an automated process to identify and submit for processing, all accounts that would fall into the category of uncollectable according to our statutes and policies. This process would submit all accounts, as they meet certain requirements, to the manager for authorization to be declared uncollectable. If the manager authorizes, the KEWES system will automatically make the required changes to the account to indicate the uncollectable status. This process will greatly streamline what is currently required.*
- Current staffing continues to be the reason for not addressing the uncollectable backlog.*
- Our current process for declaring accounts uncollectable calls for two levels of authorization (management) on any account owing over \$100. Accounts under \$100 can be declared uncollectable with one authorization. The KEWES process will require one authorization.*

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

**FINDING 01-CWD3-23: The Cabinet For Workforce Development Should Improve
Local Area Network Server Security and Consistently Apply Policies To All Servers**

State Agency: Cabinet for Workforce Development

The Cabinet for Workforce Development (CWD), should improve security of the LAN servers. Additionally, CWD should consistently apply security policies to all NT servers.

We reviewed the security for specific servers that were identified within two (2) critical domains for CWD. One (1) of these domains is managed by the technical support staff in the Division of Computer Services, and the other is managed by the Management Information System branch in the Division of Administration and Financial Management. Using general scanning tools we queried these domains to identify all Primary Domain Controllers, Backup Domain Controllers, and Structured Query Language servers. We then reviewed information divulged on specific servers within these domains to determine the established password policies and specific services that might be available on these systems.

Upon review of the password policies identified, we determined that the administrative password policies established were not consistently followed. Additionally, a vulnerability scan was performed on these servers that identified security issues concerning the available web server software and FTP services running on the systems. It was noted that some versions of the web server software could allow a remote attacker to run commands on a web server remotely and gain control of the computer. Also, older versions of FTP software were identified, which could allow attackers to remotely initiate a denial of service condition. Technical support staff of the CWD should ensure that upgrades and patches have been installed or otherwise remove these services.

To help ensure the security of a network, it is necessary for a strong password policy to be developed and implemented on all servers within the network. If servers within a network are not sufficiently secured, the network could be compromised through one of these more vulnerable paths. To ensure adequate security, all software should be kept updated.

Recommendation

We recommend CWD review all servers within the agency-owned domains to ensure that the password policy established on all servers complies with the guidelines specified by the agency. Further, we suggest that all services active on the CWD servers be reviewed to ensure the most recent upgrades and patches have been installed.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CWD3-23: The Cabinet For Workforce Development Should Improve Local Area Network Server Security and Consistently Apply Policies To All Servers (Continued)

Management's Response and Corrective Action Plan

*In response to the state auditor findings of December 18, 2001 the following improvements have been made to the **WFDESNT Domain**, which includes two servers:*

- *These servers have been upgraded with current patches or software upgrades as needed to improve security for this domain.*
- *IIS was removed from this domain on January 11, 2002.*
- *The Account policies applicable to these servers have been revised to include password expiration limits.*

In addition, it is the intent of the Cabinet to merge this domain with WFDCNT for centralized control.

*In response to the state auditor findings, the following improvements have been made to the **WFDCNT Domain**:*

- *Listed users on the domain that had passwords not expiring have been updated to include a required expiration.*
- *The account policies for the servers in this domain have been revised to include password expiration limits.*
- *Administrator password has been changed and is not being used.*
- *Theses servers have been upgraded with current patches or software upgrades as needed to improve security for this domain.*

In addition the Cabinet has purchased equipment to install two firewalls.

**COMMONWEALTH OF KENTUCKY
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

Material Weaknesses and/or Material Instances of Noncompliance:

FINDING 01-LAB1-24: The Labor Cabinet’s Division Of Administration Should Apply The Accrual Basis Of Accounting To The Special Fund

State Agency: Labor Cabinet, Special Fund

The National Council on Governmental Accounting (NCGA) Statement 1 states in part, “Proprietary fund revenues and expenses should be recognized on the accrual basis. Revenues should be recognized in the accounting period in which they are earned and become measurable; expenses should be recognized in the period incurred, if measurable.”

The Special Fund is considered to be and has been classified by the Commonwealth’s FAC as a proprietary fund type. The Labor Cabinet’s Division of Administration uses the cash basis to account for the Fund rather than the accrual basis.

A representative of the Division of Administration stated that the accrual basis is not used because “this is governmental accounting – not for-profit accounting.”

Failure to utilize the correct basis of accounting causes revenues and expenses to be recorded in the wrong period thereby causing the entity’s financial statements to be incorrectly stated.

Recommendation

We recommend that the staff of the Division of Administration be trained on the application of the correct accounting procedures for proprietary fund types. Additionally, we recommend that the Division of Administration apply the accrual basis of accounting to the Special Fund and that accrual basis financial statements be maintained including balance sheets.

Management’s Response and Corrective Action Plan

As part of our research for this audit finding, we consulted with the Controller for the Commonwealth of Kentucky. According to the Controller, state government maintains its accounting system on a cash basis during the year to comply with the legal requirements for budgeted funds (including the Special Fund). However, appropriate entries are made to record accrual information for financial

**COMMONWEALTH OF KENTUCKY
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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-LAB1-24: The Labor Cabinet’s Division Of Administration Should Apply The Accrual Basis Of Accounting To The Special Fund (Continued)

Management’s Response and Corrective Action Plan (Continued)

reporting purposes. These entries include the reclassification of closing period activity into the appropriate receivable or payable category, and the entries for year-end receivables and payables.

Further, according to the Controller, the NCGA statement cited by the auditor also states in pertinent part as follows, “Conflicts between legal provisions and generally accepted accounting practices (GAAP) do not require two accounting systems. Rather, the accounting system may be maintained on a legal-compliance basis, but should include sufficient additional records to permit GAAP-based reporting.”

Therefore, it is our position that the Special Fund is using the accounting basis mandated for agencies of the Commonwealth of Kentucky, which, according to the Controller, complies with the requirements of NCGA Statement 1. Accordingly, the system used by the Special Fund will not be changed.

Auditor’s Reply

We concur that the Special Fund is not required to maintain two (2) accounting systems. However, the Special Fund is required to maintain sufficient additional records to permit GAAP-based reporting, which it failed to do.

The Commonwealth requires agencies to submit a closing package that, among other things, facilitates conversion from the cash basis to the accrual basis of accounting. The scope of our audit was to include the closing package prepared by the Special Fund; however, the Special Fund did not provide the auditing firm with the required closing package forms.

The staff of the Special Fund did not maintain sufficient records to recognize accounts receivable, allowance for doubtful accounts, accounts payable, depreciation expense and the claims reserve. At any given reporting date the fund is able to provide its cumulative cash position however, it is unable to determine its accrual basis equity position on its own which, in our opinion, is one of the most vital indicators of fund stability.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-LAB1-24: The Labor Cabinet’s Division Of Administration Should Apply The Accrual Basis Of Accounting To The Special Fund (Continued)

Auditor’s Reply (Continued)

The objective of an audit is to express an opinion on financial statements that are the responsibility of the entity’s management. It is our impression that the management, in this instance, assumed that responsibility for the financial statements rested with the audit firm.

American Institute of Certified Public Accountants (AICPA) Professional Standards, Code of Professional Conduct, Rule 101 states that a member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council. Proposed U.S. General Accounting Office (GAO) standards, discussed below, state that in all matters relating to the audit work, the audit organization and the individual auditors, whether government or public, should be free both in fact and appearance from personal, and external, and organizational impairments to independence and should maintain an independent attitude and appearance.

In May 2001, the GAO issued an exposure draft (ED), Independence, which would amend Government Auditing Standards. The ED would revise the second general standard in Government Auditing Standards to expand the definition of personal impairments, highlight the distinction between external and internal reporting, and acknowledge the ways that organizations can avoid organizational impairments to independence.

The revisions proposed in the ED clarify various issues relating to the organizational independence of government auditors. The ED impacts a broad range of government auditors at the federal, state, and local levels. In addition to possibly impacting independent auditors who rely on audit reports issued by such auditors, the ED also could have a significant impact on CPA firms. The ED addresses many of the issues included in recent Securities and Exchange Commission (SEC) requirements for the independence of auditors who report on financial statements filed with the SEC. Providing bookkeeping or other similar services is listed as a nonaudit service that would create a personal impairment. Accordingly, maintaining depreciation schedules, converting an entity’s records from cash basis to accrual basis, or acting as a servicing bureau for payroll all could be prohibited services for CPA firms auditing the entity’s financial statements.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

**FINDING 01-LAB1-24: The Labor Cabinet's Division Of Administration Should
Apply The Accrual Basis Of Accounting To The Special Fund (Continued)**

Auditor's Reply (Continued)

The Special Fund does not maintain sufficient additional records to permit GAAP-based reporting and therefore, fails to comply with the National Council on Governmental Accounting Statement 1.

**COMMONWEALTH OF KENTUCKY
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-LAB2-25: The Labor Cabinet’s Division Of Administration Should Bill Assessment Receivables In A Timely Manner For The Special Fund

State Agency: Labor Cabinet, Special Fund

Sound internal control procedures require that receivables be billed in a timely manner and on a regular basis.

The Special Fund billed carriers for reimbursement of pre-1982 awards only twice during the fiscal year. Furthermore, only one (1) additional billing had been mailed as of December 12, 2001 and there was a significant delay in mailing those bills.

Management stated that this was due to the implementation of a new system to account for assessments receivable. Use of the old system was discontinued before the new system was operating effectively.

Failure to bill carriers in a timely manner and on a regular basis results in the loss of the ability to properly monitor and track receivables.

Recommendation

We recommend that the Special Fund bill carriers on a quarterly basis.

Management’s Response and Corrective Action Plan

The Special Fund recognizes that quarterly billings to obtain reimbursement for the employer’s share of pre-1982 occupational disease awards are required pursuant to the applicable version of KRS 342.316 (13) (a). However, as noted by the auditor, deficiencies in the Special Fund’s data management system have presented a major obstacle to meeting this obligation.

In an effort to solve this and other payment related problems, the Labor Cabinet contracted with GOT in February of 2000 to develop and implement a new claim payment and management system (CPMS), including a new billing system for pre-1982 occupational disease awards. The new system was designed to produce timely (quarterly) and accurate billings and was originally set for implementation in March 2001. However, due to the scope and complexity of the project, delays

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

**FINDING 01-LAB2-25: The Labor Cabinet’s Division Of Administration Should
Bill Assessment Receivables In A Timely Manner For The Special Fund (Continued)**

Management’s Response and Corrective Action Plan (Continued)

were encountered and the new payment system did not become operational until June 2001. Moreover, in spite of substantial efforts by Special Fund and GOT staff, the new system was not capable of producing billings until August 2001.

However, since August 2001, the billing system has been further refined and steps are being taken to implement quarterly billings as recommended.

**COMMONWEALTH OF KENTUCKY
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(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-LAB3-26: The Labor Cabinet’s Division of Administration Should Improve The Assessments Receivable System Reports For The Special Fund

State Agency: Labor Cabinet, Special Fund

Sound internal control policies require access to adequate accounting data. This includes assessments receivable reports as well as aging reports of receivables.

Management informed us that the system used to track assessments receivable cannot produce an aging of outstanding assessments receivable. Also, during the audit, employees were unable to generate an assessments receivable report as of a specific date. This report was later produced by programmers hired by the Special Fund.

Without an aging of assessments receivable, it is difficult if not impossible for the Special Fund to monitor past due accounts and pursue serious delinquencies when they occur. Due to the timing of the last billing prior to June 30, 2001, it was noted that receivables were at least 120 days past due at year-end. We also noted that there was moderate collection activity throughout the year compared to the outstanding balances. The Special Fund was unable to determine if any listed receivables were beyond any applicable legal collection limitations.

Recommendation

We recommend that the Special Fund have the system programmed to generate assessments receivable reports as well as aging reports of receivables. In addition, we recommend that the appropriate employees be trained to produce these reports without the aid of a programmer and that they actively investigate receivables excessively past due. If permitted, the Special Fund should assess interest and/or penalties against late payments.

Additionally, the Special Fund indicated that the new system would not permit the Fund to track receipts on a per claim basis. Therefore, if a specific claim is in dispute, there appears to be no simple way for the Special Fund to determine if payment on that particular claim is being withheld.

Management’s Response and Corrective Action Plan

As stated in finding 2, management has been aware of deficiencies with the Special Fund’s billing system for pre-1982 occupational disease awards for some time and has taken major steps to rectify the problems. Prior to contracting with GOT for the new claim payment and management system (CPMS), Special Fund

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-LAB3-26: The Labor Cabinet’s Division of Administration Should Improve The Assessments Receivable System Reports For The Special Fund (Continued)

Management’s Response and Corrective Action Plan (Continued)

staff performed a review of accounts receivable to identify inactive accounts in an effort to eliminate unnecessary billings and facilitate collection of overdue amounts. The review process resulted in the collection of a number of overdue accounts, and allowed management to document legal reasons to discontinue a large number of improper billings, including all billings to the Coal Miners’ Pneumoconiosis Fund, the Uninsured Employers’ Fund, and a specific coal company. Deletion of these accounts eliminated unnecessary quarterly billings for hundreds of claims and reduced the accounts receivable list by over 6.5 million dollars. Other inactive accounts were identified in the process, but definitive action had not been taken as of the FY 01 audit. Management recognizes the need to complete the review of inactive accounts to facilitate collection of past due amounts or deletion of amounts which are not collectible, and steps will be taken to complete this process in the near future.

With regard to the specific recommendations of the auditor, management will engage GOT to develop and implement a program to allow Special Fund staff to produce a receivables report and aging reports of receivables, and permit staff to track receipts on a per claim basis. Furthermore, staff will be assigned responsibility for the active investigation and pursuit of overdue accounts, with interest and penalties, if permitted.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CPE3-27: The Council On Postsecondary Education Should Investigate Alternatives To Address The Apparent Inconsistency Between The Current Council Guidelines And The Current Provisions Of KRS 164.7919(1)(C)

State Agency: Council On Postsecondary Education (CPE)

Per review of Endowment Match Program supporting documentation, endowments matched from the Regional University Excellence Trust Fund were not limited to the university-selected area of concentration. KRS 164.7919(1)(c) states that the purpose of the Regional University Excellence Trust Fund is to “encourage regional universities to develop at least one nationally recognized program of distinction or one nationally recognized applied research program . . .” However, the guidelines do not require matching in any specific area, but permit endowment matching regardless of the discipline.

CPE’s disbursement of funds was not in compliance with KRS 164.7919.

We understand that at the time KRS 164.7919 was codified into law funding for programs of distinction and nationally recognized applied research programs was appropriated through CPE’s Regional University Excellence Trust Fund. We also understand that beginning with the 1999-2000 biennium it is CPE’s understanding that all funding for programs of distinction and nationally recognized applied research programs is now appropriated directly to the institutions. Accordingly, CPE’s guidelines do not require matching in the university-selected areas of concentration and, therefore, the guidelines do not appear to be in accordance with the current provisions of KRS 164.7919 (1)(c).

Recommendation

We recommend CPE investigate alternatives to address the apparent inconsistency between the current CPE guidelines and the current provisions of KRS 164.7919(1)(c). Alternatives to consider include (1) pursuing legislative update to KRS 164.7919(1)(c); (2) request that future appropriation bills specify the purpose of the current funding appropriated through the Regional University Excellence Trust Fund; or (3) revise CPE guidelines to comply with the provisions of KRS 174.7919 (1)(c).

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

**FINDING 01-CPE3-27: The Council On Postsecondary Education Should Investigate Alternatives To Address The Apparent Inconsistency Between The Current Council Guidelines And The Current Provisions of KRS 164.7919(1)(C)
(Continued)**

Management's Response and Corrective Action Plan

The Council staff agrees to discuss the need for updates to KRS 164.7919 and to request that Appropriations Bill language clearly specify the purpose of approved funding.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CPE4-28: The Council On Postsecondary Education Should Revise The Guidelines Applicable To The Regional University Excellence Trust Fund To More Clearly Define The Amount Of Matching That Will Be Permitted In The Areas Of Arts And Humanities

State Agency: Council on Postsecondary Education

Per review of Endowment Match Program supporting documentation, endowments matched from the Regional University Excellence Trust Fund were not limited in the areas of arts and humanities. CPE approved guidelines to recognize that arts and humanities do add quality of life and permit a limited amount of matching in these areas. However, the term “limited” is not defined and in practice CPE did not limit the amount of endowment matching funds in these areas.

CPE’s disbursal of funds was not in accordance with CPE approved guidelines.

The Regional University Excellence Trust Fund guidelines do not clearly define the amount of matching that will be permitted in the areas of arts and humanities resulting in the practice that CPE did not limit the amount of endowment matching funds in these areas.

Recommendation

The guidelines applicable to the Regional University Excellence Trust Fund should be revised to more clearly define the amount of matching that will be permitted in the areas of arts and humanities.

Management’s Response and Corrective Action Plan

The Council staff believes that the Council, in considering individual institutional requests for endowment match funds, considered what limited means in regard to arts and humanities. A written definition is not, in our opinion, necessary or advantageous.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CPE5-29: The Council On Postsecondary Education Should Implement Additional Procedures To Ensure That The Required Information Is Requested If Not Received In A Timely Manner

State Agency: Council on Postsecondary Education

The Memorandum of Understanding between CPE and the Kentucky Department of Education (KDE) requires an annual accounting of administrative funds disbursed under the Kentucky Educational Excellence Scholarship (KEES) program to the KDE with a return of any unused funds to CPE. The annual accounting and the applicable unused funds, if any, have not been received as required under the signed Memorandum of Understanding.

CPE was not able to verify that the funds are being expended as intended or to determine if any funds should have been returned.

The procedures in place did not include follow up procedures to request such information not received in a timely manner.

Recommendation

CPE should implement additional procedures, including the implementation of a tickler system, to ensure that the required information is requested if not received in a timely manner.

Management's Response and Corrective Action Plan

The Council staff agrees with the finding. The Kentucky Department of Education has been notified and is in the process of preparing the required report. A tickler system has been developed and the KHEAA and the KDE will be notified on a timely basis when future reports are due.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CPE6-30: The Council On Postsecondary Education Should Ensure Annual Reports For The Postsecondary Equine Trust And Revolving Fund Are Received In A Timely Manner

State Agency: Council on Postsecondary Education

The annual reports certifying expenditure and use of funds disbursed under the Postsecondary Education Equine Trust and Revolving Fund had not been received from the applicable institutions as required under the program guidelines.

CPE was not able to verify that the funds are being expended as intended.

The procedures in place did not ensure the receipt of such information in a timely manner.

Recommendation

CPE should implement additional procedures to ensure that the required information is received in a timely manner. Follow up procedures should also be established to request information not received in a timely manner.

Management's Response and Corrective Action Plan

The Council staff agrees with the finding. The recipients of equine trust funds have been notified that the reports are past due. A tickler system has been developed and future recipients will be notified when reports are due.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CPE7-31: The Council On Postsecondary Education Should Ensure Annual Reports For The Professional Education Preparation Program, Metroversity Consortium, And Telecommunication Consortium Are Received In A Timely Manner

State Agency: Council on Postsecondary Education

The annual reports certifying expenditure and use of funds disbursed under various pass-through programs were not received as required under the signed memoranda of understanding. The reports from two (2) of the three (3) recipients under the Professional Education Preparation Program were not received. Additionally, the reports from the recipients under both the Metroversity Consortium and the Telecommunication Consortium were not received.

CPE was not able to verify that the funds are being expended as intended.

The procedures in place did not ensure the receipt of such information in a timely manner.

Recommendation

CPE should implement additional follow up procedures, including the implementation of a tickler system, to ensure that the required information is requested if not received in a timely manner.

Management's Response and Corrective Action Plan

The Council staff agrees with the finding. A tickler system has been developed to ensure timely receipt of the required reports. Each pass-through program will be assigned to a program staff person to ensure that expenditures are properly authorized and the program reports are filed.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-REV2-32: The Revenue Cabinet Should Substantially Improve All System Related Controls Surrounding The Modernized Front End System

State Agency: Kentucky Revenue Cabinet

We reviewed the data entry controls concerning tax forms processed within the Revenue Cabinet through the Modernized Front End (MFE) system for fiscal year ending June 30, 2001. We noted MFE system deficiencies including system design inefficiencies and inadequacies; inaccessible software support, source code, and application monitoring; and lack of system administration controls and adequate documentation. These deficiencies have been affirmed by Revenue and a restructure of the MFE system is currently underway.

General issues of concern include:

- The logical security in place within the MFE system is not sufficient to ensure the protection of the data and programs within the system. All users who have access to the MFE process have been placed within a group that provides them full access to the application and related files contained within the MFE data server. This access level could lead to intentional or unintentional corruption or deletion of files and application programs.
- Accounting audit trails are not sufficient to trace or verify transactions or data changes.
- Data preparation controls are not sufficient to ensure all documents are properly entered and posted. Currently, Revenue performs reconciliation procedures upon completion of document processing to ensure the accuracy and completeness of the transactions

Revenue has assumed complete responsibility for the MFE system and has continued to modify program codes in an attempt to stabilize the system. Maintaining the day-to-day processing fixes to the system has not allowed necessary resources to focus on internal controls of the system or the restructuring process.

To ensure the completeness and accuracy of the data that is processed through the MFE system, several controls must be in place. First, a strong control over logical security is necessary to ensure unauthorized modifications are not made to files or programs. Second, audit trails should be maintained and kept current. These files can be used for trouble shooting as well as reporting. Finally, adequate data entry and processing controls are necessary to ensure only authorized data is being input into the system and the data entered is complete and accurate.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-REV2-32: The Revenue Cabinet Should Substantially Improve All System Related Controls Surrounding The Modernized Front End System (Continued)

Recommendation

We recommend Revenue strengthen the controls around the MFE system. Specifically, we suggest these controls include:

- A restructuring of the current logical security for the system to remove the excessive access provided to the MFE users and to restrict access privileges based on job function.
- An enhancement of the accounting audit trails to allow the tracing or verification of transactions and data changes through the process.
- An expansion of procedures surrounding the data preparation of documents to ensure all documents received are properly entered, batched totals are accurate, and all transactions are processed through the MFE system.

Further, Revenue should be diligent in its restructuring plans to ensure known deficiencies within the system are addressed in a responsible and timely manner.

Management's Response and Corrective Action Plan

The Kentucky Revenue Cabinet (KRC) agrees with the Auditor's findings and is currently in the process of re-structuring the Modernized Front End (MFE) to address these issues. The estimated completion date for the MFE re-structuring is July 2002.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

**FINDING 01-CWD4-33: The Division Of Unemployment Insurance Did Not Have A
Reliable Trial Balance**

State Agency: Cabinet for Workforce Development

The trial balance for UI tax collections has not been reconciled for FY 01. The agency was not able to provide the documentation to support the amounts recorded on the FAC AFR-30 and AFR-32 forms of the closing package for accounts receivable because of this.

UI could not provide a trial balance, aging report, or list of balances by employer account to perform any testing to determine whether the Tax Branch accounts receivable balances were accurate. In addition, we could not rely on the controls of the UI computer system to provide accurate reports related to employer tax including a trial balance of delinquent contributions.

Appropriate accounting procedures would ensure outputs of a computer system accurately reflect inputs and that system reports be verified prior to inclusion in external reports such as the FAC AFR-30 and AFR-32 closing package forms.

Recommendation

The agency should produce a reconciled trial balance so that amounts recorded in the closing package are accurate. Corrections to computer systems and additional system controls must be implemented to prevent the submission of information from an unverified trial balance.

Management's Response and Corrective Action Plan

The agency agrees with the auditors' recommendation and the trial balances will be up to date before next audit. The recommendation to request GOT to create a report of accounts receivable balances by employer has been requested.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CWD5-34: The Division Of Unemployment Insurance Continues To Materially Misrepresent Its Corrective Action Plan To Provide A Trial Balance For Employer's Tax Collections

State Agency: Cabinet for Workforce Development

This is the third consecutive year in which UI has not implemented its corrective action plan, therefore materially misrepresenting the stated corrective action. The trial balance for UI has not been reconciled since FY 99. Due to this weakness the accounts receivable balance could have been materially misstated since FY 99. In addition, the internal controls of the system do not provide accurate reports related to employer tax including a trial balance or delinquent contributions.

UI could not provide us a trial balance, aging report, or a list of balances by employer account to verify accurate balances.

Management has not implemented its corrective action plan. Management has stated since FY 99 they will eliminate the current trial balance process and provide complete, timely and accurate report information. The agency employed a former Trust Fund Coordinator to assist in the reconciliation of all outstanding trial balances in FY 00. The new coordinator has made recommendations in FY 00 that were not followed up in FY 01. Management stated that implementing KEWES was one of the main criteria for the trial balance not being reconciled as of FY 01. However, the process has not improved.

Recommendation

The agency should adhere to its corrective action plan submitted to the auditors. Management should monitor the process and update as needed. The agency should produce a reconciled trial balance so that the amounts recorded in the closing package can be tested for reasonableness and accuracy. Corrections to computer systems and additional system controls must be implemented to prevent the submission of an unverified trial balance.

Management's Response and Corrective Action Plan

The new Trial Balance process is now in place and efforts are being made to work through and verify the trial balance for each processing period until data is current. This has to be completed in order to run 2002 rates and federal certification.

Beginning with the 1-2002 quarterly reports, there should be no problem completing each trial balance in a timely manner.

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

***Reportable Conditions Relating to Internal Control and/or Reportable
Instances of Noncompliance:***

**FINDING 01-AGR1-35: The Department Of Agriculture Should Ensure
Subrecipients Meet OMB Circular A-133 Audit Requirements**

State Agency: Department of Agriculture
Federal Program: CFDA 10.550 – Food Distribution
Federal Agency: U.S. Department of Agriculture
Pass-Through Agency: Not Applicable
Compliance Area: Subrecipient Monitoring
Amount of Questioned Costs: None

The Department of Agriculture, acting as a pass-through entity, distributed a total of \$15,697,806 in food commodities to Kentucky schools and residential child-care institutions through USDA's Food Distribution program, during FY 01. We tested the Department of Agriculture's system for monitoring subrecipient compliance with OMB Circular A-133 provisions and identified nine (9) school systems that met the threshold for having an audit during FY 01. We noted the Department of Agriculture does not have a system in place for tracking its subrecipients who were required to have an audit or following up on findings related to the Food Distribution program. By not tracking subrecipient compliance with audit requirements, the Department of Agriculture is not in compliance with Section .400 of OMB Circular A-133 which requires pass-through entities to ensure that audits were performed and the subrecipient takes appropriate and timely corrective action.

To participate in the Food Distribution program, schools and residential child-care institutions must also participate in the National School Lunch Program, as specified under 7 CFR Part 250. The purpose of the Food Distribution program is to improve the diets of school and preschool children and to increase the market for domestically produced foods acquired under surplus removal or price support operations.

As subrecipients of federal awards, Kentucky school districts and entities that expend at least \$300,000 in cash or noncash federal assistance are required, in accordance with OMB Circular A-133 and KRS 156.265, to have an audit performed annually by an independent certified public accounting firm. The Department of Education's Division of Finance performs desk reviews of the audit reports to ensure corrective action is made for any deficiencies or questioned costs that were noted.

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-AGR1-35: The Department Of Agriculture Should Ensure Subrecipients Meet OMB Circular A-133 Audit Requirements (Continued)

OMB Circular A-133, Subpart D - Federal Agencies and Pass-Through Entities, Section .400 states,

- d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the Federal awards it makes:
- Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient's fiscal year have met audit requirements.
 - Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.
 - Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.
 - Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.

Recommendation

The Department of Agriculture, acting as a pass-through entity, should work in conjunction with the Department of Education to ensure audit findings related to the Food Distribution program are communicated to appropriate program personnel and that corrective action on all findings is made in accordance with laws and regulations.

Management's Response and Corrective Action Plan

The Division of Food Distribution concurs with your findings regarding Subrecipient Monitoring as outlined in OMB Circular A-133. We propose the following actions be taken to be in compliance with this requirement.

At the end of the school fiscal year, the Division of Food Distribution, field staff branch manager will run a Year End Dollar Report listing each school system receiving commodity food and the total dollar amount of assistance received in the form of commodity foods. Using this report the field branch manager will*

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-AGR1-35: The Department Of Agriculture Should Ensure Subrecipients Meet OMB Circular A-133 Audit Requirements (Continued)

Management's Response and Corrective Action Plan (Continued)

identify any system receiving \$300,000 dollars, or more, and record each system on the Systems Requiring Audit Review report.

On or before March 1st, of the following school year the field branch manager will contact the Department of Education, Division of Finance, and request written documentation stating the fiscal year desk audit they perform on each audit has been completed for all schools.

To ensure compliance with Federal OMB Circular A-133, the field branch manager will, no later than April 15th of each year, complete the review of audits for each school system receiving \$300,000 or more in commodity foods submitted to the Department of Education, Division of Finance and posted on their web site, <http://www.kde.state.ky.us/odss/finance/finaudit.asp>. All findings will be reported by school system on the Systems Requiring Audit Review report and documentation regarding corrective action taken will be attached. Should an audit not be available for review the field branch manager will instruct the program coordinator responsible for that school system to visit that system and bring a copy of the audit to the Frankfort office for review.

When all required audit reviews are completed the field branch manager will send a memo confirming completion of the audit process to the director and a copy of the memo, Year End Dollar Report, Systems Requiring Audit report, with attachments will be placed in the central office file. The field branch manager will forward a copy of all documentation to the Division of Fiscal and Intergovernmental Management for their records and use.

The audits for SY' [State Fiscal Year] 01 will be reviewed and completed no later than May 24, 2002. We will forward a copy of the report to your office and to the Division of Fiscal and Intergovernmental Management.

** Year End Dollar Report- This report will be compiled manually for the SY 2001 review. However, we have contacted the programmer of our custom computer program to develop this report and it will be available for the SY 2002 audit reviews.*

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC2-36: The Cabinet For Families And Children Should Maintain And Produce Records To Adequately Support Expenditures

State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.558 – Temporary Assistance for Needy Families

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Allowable Costs/Cost Principles and Eligibility

Amount of Questioned Costs: Not Applicable

We tested a sample of 42 payments, consisting of object codes E450, E462, and E464 expenditures, to participants in the Kentucky Transitional Assistance Program. CFC failed to produce records to support expenditures and follow the PA-32 Procedural Instructions that are part of the Community Based Services Forms Manual for some of the sampled items. The instructions include detailed descriptions of how PA-32s should be completed by caseworkers.

We noted the following weaknesses:

- Recipient files were missing for four (4) of 42 cases tested.
- PA-32 was missing from file in one (1) case.
- Incomplete PA-32s in seven (7) cases (forms contained blank lines).
- PA-32 supportive service payment not supported by receipt or invoice in one (1) case.
- Incomplete information in recipient file in five (5) cases:
 - No income verification (pay stub) in one (1) case.
 - No verification of child's birth information (birth certificate, social security card, immunization records) in three (3) cases.
 - PA-85 (Referral for Child Care) missing in one (1) case.

CFC has not taken adequate measures to correct this problem as similar problems were noted in the FY 00 audit. However, there has been significant improvement and CFC should be recognized for its efforts.

CFC cannot be assured that all payments for both recurring and non-recurring expenses were valid. Also, if PA-32s are not completed according to instructions, the potential for fraud and misuse of funds exists.

**COMMONWEALTH OF KENTUCKY
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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC2-36: The Cabinet For Families And Children Should Maintain And Produce Records To Adequately Support Expenditures (Continued)

Federal regulations at 45 CFR 92.20 (a) (2), say “[f]iscal control and accounting procedures of the State . . . must be sufficient to . . . permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.”

Federal regulations at 45 CFR 92.42(b) (1), also say “. . . records must be retained for three years from the starting date specified in paragraph C.”

Good internal controls dictate that procedures be followed to ensure payments are made only for approved and allowable goods and services.

Recommendation

We recommend CFC remind staff of the importance of maintaining participant case files. Records should be produced and maintained to adequately support expenditures. The PA-32 forms should be completed according to instructions in all cases.

Management’s Response and Corrective Action Plan

Quality Central Staff are presently posting reminders on KAMES [Kentucky Automated Management and Eligibility System] News quarterly on the importance of correctly following procedures for Supportive Services and payments made by Form PA-32. KAMES News is accessed by all Family Support Staff.

We will advise staff, via an Each Local Office Memo to emphasize in training sessions as well as in staff meetings the importance of the completion and maintenance of the Form PA-32 and any verification needed. We will also emphasize the importance of completing and maintaining the case files.

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(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC3-37: The Cabinet For Families And Children Should Present Accurate Notes To The Schedule of Expenditures Of Federal Awards

State Agency: Cabinet for Families and Children

Federal Program: All Federal Assistance Programs With Subrecipients

Federal Agency: U.S. Department of Agriculture,

U.S. Department of Energy,

U.S. Department of Health and Human Services, and

U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

During our testing of subrecipient monitoring, we noted the following problems with the schedule of subrecipients:

- The schedule included both subrecipients and vendors. Vendors should not be included in the schedule of subrecipients.
- Amounts provided to subrecipients were not correctly identified for each federal program.
- Some expenditures were incorrectly coded in MARS. For example, CFC codes expenditures to Area Development Districts (ADDs) in MARS as E415, which is Program Administration Costs-1099 Reportable. However, the ADDs are actually subrecipients and quasi-governmental entities that do not file tax returns.

Failure to distinguish between subrecipients and vendors increases the chances that key audit requirements could be missed. It is our understanding that CFC requires all contractors to have an audit. This requirement ensures that true subrecipients obtain the required OMB Circular A-133 audit, as well as ensure that applicable vendors are properly monitored.

In addition, failure to distinguish between subrecipients and vendors may overstate the amounts reported as being sent to subrecipients in the notes to the Schedule of Expenditures of Federal Awards.

OMB Circular A-133 Subpart C .300(d) states the auditee should “[p]repare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with section .310.” Section .310 (b) (5) states that the Schedule of Expenditures of Federal Awards should contain, at a minimum “[t]o the extent practical, pass-through entities should identify in the schedule the total amount provided to subrecipients from each Federal program.”

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC3-37: The Cabinet For Families And Children Should Present Accurate Notes To The Schedule of Expenditures Of Federal Awards (Continued)

OMB Circular A-133 Subpart D .400(d) states that a pass-through entity should perform the following for the federal awards it makes:

- (2) [A]dvise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.
- (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
- (4) Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

These requirements are also stated in the APA SEFA instructions given to CFC every year.

Recommendation

We recommend CFC obtain a clear understanding of the difference between a subrecipient and a vendor and the importance of such a distinction. This would lead to an accurate presentation of the notes to the Schedule of Expenditures of Federal Awards.

We also recommend CFC review all expenditure coding in MARS to ensure that expenditures are coded correctly.

Management's Response and Corrective Action Plan

The cabinet realizes the importance of complying with the Sub-Recipient monitoring requirement of OMB Circular A-133. There will be a joint effort within the Office of Program Support to ensure that the proper steps are taken to ensure compliance regarding the subrecipient\vendor issue and the expenditure coding finding.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC4-38: The Cabinet For Families And Children Should Develop A Policies and Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed

State Agency: Cabinet for Families and Children

Federal Program: CFDA 17.253 – Welfare-to-Work Grants to States and Localities,
CFDA 93.558 – Temporary Assistance for Needy Families,
CFDA 93.563 – Child Support Enforcement,
CFDA 93.568 – Low-Income Home Energy Assistance,
CFDA 93.575 – Child Care and Development Block Grant, and
CFDA 93.596 – Child Care Mandatory and Matching Funds of the
Child Care and Development Fund

Federal Agency: U. S. Department of Labor and
U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

CFC contracts with local not-for-profit organizations, community action agencies, and county attorneys to provide Welfare-to-Work (WtW), Temporary Assistance for Needy Families (TANF), Child Support Enforcement (CSE), Low-income Home Energy Assistance Program (LIHEAP), and Child Care and Development Fund (CCDF) services to needy families. As subrecipients of federal awards, organizations that expend in excess of \$300,000 are required to have a single or program-specific audit in accordance with OMB Circular A-133.

Audits of subrecipients must be submitted to CFC for review within nine (9) months after the end of the fiscal year being audited. We requested monitoring reports, subrecipient contracts, and audit reports to test CFC's compliance with OMB Circular A-133 provisions. We noted three subrecipients failed to submit an audit report to CFC for FY 00. The Cabinet for Health Services, Office of the Inspector General (CHS/OIG), who has a contract with CFC to perform desk reviews, among other duties, has not received or timely performed 11 desk reviews for FY 00 audits for CFC subrecipients. During the contract monitoring testing, one subrecipient was missed in the monitoring process for both FY 00 and FY 01.

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC4-38: The Cabinet For Families And Children Should Develop A Policies and Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed (Continued)

CFC has not taken the appropriate steps to correct similar problems that were noted during FY 98, FY 99, and FY 00. Deficiencies noted during our review follow:

CFDA	OMB Circular A-133 Audit Deficiencies
93.558 TANF	No desk review was obtained for three (3) audits.
93.563 CSE	No desk review was obtained for three (3) audits.
93.568 LIHEAP	Required audit report changes were not made for one (1) audit. No desk review was obtained for six (6) audits, two (2) of which were vendors for TANF and LIHEAP (shown above). One (1) audit report was not obtained.
93.575 CCDF 93.596 CCMF	Two (2) audit reports were not obtained. The financial audit was confused with the OMB Circular A-133 audit. Audit reports and correspondence received at CFC were not being sent to CHS/OIG timely.

CFDA	Contract Monitoring Deficiency
17.253 WtW	No contract monitoring performed for two (2) years on one (1) contract. Expenditures: FY 00 \$1,644,505 FY 01 \$2,762,165

CFC cannot be assured that subrecipients are expending federal awards for the intended purpose and complying with the requirements of OMB Circular A-133 without having proper monitoring procedures in place.

OMB Circular A-133, Subpart B states: “[n]on-Federal entities that expend \$300,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part.”

CFC has the following responsibilities under OMB Circular A-133, Subpart D:

- 1) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC4-38: The Cabinet For Families And Children Should Develop A Policies and Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed (Continued)

- 2) Ensure required audits are performed and require subrecipients to take prompt corrective action on any audit findings; and,
- 3) Evaluate the impact of subrecipient activities on the pass-through entity's ability to comply with applicable federal regulations.

The Commonwealth of Kentucky Master Agreement, which is the contract between CFC and CHS/OIG states that OIG will: 1) perform reviews and audits to ensure financial compliance with state and federal laws and regulations and evaluate external audits performed for the Cabinet, and perform other related services, 2) complete desk reviews of A-133 audits within six (6) months of receipt and 3) meet the standard 100% of the time.

OMB Circular A-133 §____.225 states;

[n]o audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part. In cases of continued inability or unwillingness to have an audit conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

- (a) Withholding a percentage of Federal awards until the audit is completed satisfactorily;
- (b) Withholding or disallowing overhead costs;
- (c) Suspending Federal awards until the audit is conducted; or
- (d) Terminating the Federal award.

Recommendation

A policies and procedures manual would make the subrecipient monitoring process more effective and easier to follow. It would also ensure compliance with OMB Circular A-133 subrecipient monitoring compliance requirements. In particular, OMB Circular A-133 requires the pass-through entity (CFC) to receive audit reports from subrecipients required to have an audit in accordance with OMB Circular A-133 and issue "timely" management decisions on audit and monitoring findings, and requires subrecipients to take "timely" corrective action on deficiencies identified in audits and subrecipient monitoring. OMB Circular

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC4-38: The Cabinet For Families And Children Should Develop A Policies and Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed (Continued)

Recommendation (Continued)

A-133 does not define “timely;” however, a CFC subrecipient monitoring policies and procedures manual could define that to ensure compliance and consistency.

The written policies and procedures should contain the following at a minimum:

- 1) Communication of federal award requirements to the subrecipients.
- 2) The responsibilities for monitoring and tracking subrecipients in a timely manner, with a definition of what “timely” means. An example would be to have deadlines for the response on each correspondence sent to the subrecipient and/or independent auditor, and after a maximum number of sent correspondences (such as three (3)), the file would be forwarded to General Counsel for pursuit of non-compliant items.
- 3) Specific monitoring processes. An example would be to better use the CFC Audit Log for OIG, perhaps through weekly updates.
- 4) Methodology for resolving the findings of subrecipient non-compliance or weaknesses in internal control and a timeline for corrective action.
- 5) Requirements for processing subrecipient audits, including appropriate adjustment of pass-through entity’s accounts, such as through the sanctions mentioned above.
- 6) Require CHS/OIG to be compliant with the six (6) months turnover of desk reviews as required by the CFC contact.
- 7) Impose sanctions, disallow overhead costs, disallow expenditures, suspend federal awards, or terminate the federal award for subrecipients who fail to meet the audit requirements as set forth by OMB Circular A-133.
- 8) Deny all requests for extensions made by the subrecipient who is failing to meet said requirement.
- 9) Establish a time limit on extensions for submitting an audit.

Management’s Response and Corrective Action Plan

The Contracts Management Branch will create a policy and procedures manual to assist in the monitoring of subrecipients. Letters have been submitted to the agencies that failed to provide the Cabinet with a timely audit. Follow up is also being completed when necessary. We currently have in place a staff person that

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC4-38: The Cabinet For Families And Children Should Develop A Policies and Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed (Continued)

Management's Response and Corrective Action Plan (Continued)

part of their responsibility is to make sure that audits are received timely and provided to the OIG's office.

The Contracts Accountability Branch will ensure all contracts which contain \$300,000 or more in Federal Funds are listed for review. They will sort the contract list by allocation amounts and select those contracts of \$300,000 or more in Federal dollars for review prior to making other selections.

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC5-39: The Cabinet For Families And Children Should Comply with OMB Circular A-133 Compliance Supplement Appendix VII SAS 70 Examination Requirements

State Agency: Cabinet for Families and Children

Federal Program: CFDA 10.551-Food Stamps

CFDA 10.561–State Administrative Matching Grants for Food Stamp Program

Federal Agency: U.S. Department of Agriculture

Pass-Through Agency: Not Applicable

Compliance Area: None (Compliance Supplement Appendix VII - SAS 70 Examinations of EBT Service Organizations)

Amount of Questioned Costs: Not Applicable

Under the Food Stamps program, states must obtain an examination by an independent auditor of the state EBT service provider (service organization), which for Kentucky is the eFunds Corporation (eFunds). During a review of the Statement on Auditing Standards (SAS) 70 examination for eFunds, we noted the following:

1. The SAS 70 examination did not cover the entire period since the previous examination period. The SAS 70 audit covered 12/1/00 through 5/31/01. The previous examination covered 12/1/99 through 5/31/00. This leaves a six-month gap between examinations.
2. The examination did not contain a list of all states whose systems operate under the same control environment.

When the service provider is not required to have a SAS 70 examination covering the entire period since the previous examination period, possible control weaknesses could develop in the internal control system and not be detected in a timely manner.

Appendix VII of the OMB Circular A-133 Compliance Supplement states:

[s]tates must obtain an examination by an independent auditor of the State electronic benefits transfer (EBT) service providers (service organizations) regarding the issuance, redemption, and settlement of benefits under the Food Stamps program (CFDA 10.551) in accordance with the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No. 70, Service Organizations. Also, States are required to ensure that the service organization has these examinations performed

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC5-39: The Cabinet For Families And Children Should Comply with OMB Circular A-133 Compliance Supplement Appendix VII SAS 70 Examination Requirements (Continued)

at least annually, that the examinations cover the entire period since the previous examination period, and that the examination reports are submitted to the State within 90 days after the end of the examination period. The examination report must include a list of all States whose systems operate under the same control environment.

Recommendation

We recommend CFC comply with OMB Circular A-133 Compliance Supplement Appendix VII regarding SAS 70 Examinations of EBT Service Organizations by requiring the service provider to have an annual SAS 70 examination that covers the entire period since the previous examination period. The report should also include a list of all states whose systems operate under the same control environment.

Management's Response and Corrective Action Plan

We were aware the SAS 70 audit from eFunds did not cover a continuous twelve-month period. We have been working with eFunds to correct this situation. We have been notified by eFunds that they have entered into an agreement with Deloitte & Touche to provide SAS 70 audits for successive twelve-month periods. They are currently working on an audit that will cover the period June 1, 2001 through May 31, 2002. They are unable to audit the periods that were not audited in the past. We continue to work with eFunds to insure the next audit will include the states the audit covers. In the event we are unable to have the states covered by the audit included in the audit, we will require an addendum to the audit identifying the states covered by the audit.

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC6-40: The Division Of Child Care Should Have Formalized Logical Security Procedures To Follow For The Kentucky Child Care Management System

State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.575 – Child Care and Development Block Grant
CFDA 93.596 – Child Care Mandatory and Matching Funds of the
Child Care and Development Fund

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Not Applicable (Internal Controls)

Amount of Questioned Costs: None

As noted in the previous three (3) audits, the CFC, Division of Child Care did not provide adequate security for the Kentucky Child Care Management System (KCCMS). The CFC Office of Technology Services (OTS) administers KCCMS security. OTS followed certain security authorization procedures to establish, modify or revoke system access to KCCMS. Those procedures included efforts to ensure all system users completed a System Access Request (SAR) form to update and re-organize the security files. However, the logical security procedures were not formalized into a comprehensive security policy for CFC.

We obtained a listing of KCCMS system users from the security administrator. This listing included 209 system IDs broken out by the various service agencies. Our review noted 33 SAR forms that did not have the proper approval required to grant the access provided. This represented 15% of the population tested.

Additionally, during the prior audit we noted the system would not force users to change their password for KCCMS. During FY 01, users were required to change their password and then continue to change it every 30 days. The security administrator issued access procedures, which included password guidelines via email to KCCMS users. Again, these security procedures were not formalized into a comprehensive security policy for CFC.

Consistent application of formalized security policies provides continuity for policy implementation and sets the tone of management concern for strong system security. Formal policies provide a security framework used to educate management and users of their security responsibilities. Further, the propriety of system access levels granted cannot be ensured without properly documented and approved access requests. Levels of system access granted to users should be restricted to areas necessary for the employee to perform assigned job duties.

**COMMONWEALTH OF KENTUCKY
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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC6-40: The Division Of Child Care Should Have Formalized Logical Security Procedures To Follow For The Kentucky Child Care Management System (Continued)

Recommendation

We recommend the Division of Child Care, in conjunction with OTS, take the following steps to improve the logical access security function:

- Comprehensive computer security policies should be formally documented, approved, and implemented across all service agencies.
- The Security Administrator should make certain that all request forms are completed and properly approved to ensure proper access levels are granted to users. In addition, a listing of all accesses should be reviewed periodically to ensure employee data and access rights are current.

Management's Response and Corrective Action Plan

A security team was formed in January to comply with the recommendations of these findings. The team is made up of security administrators from OTS. Weekly meetings were held to develop security procedures. These procedures were developed for KCCMS, KAMES, KASES, and TWIST. These procedures are incorporated in a new manual, "CFC System Security Access Procedures". These procedures also include RACF security requirements. The manual has been provided to the Child Care Director to be used to incorporate them in child care policy also.

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC7-41: The Cabinet For Families And Children Should Ensure Every Effort Is Made To Establish And Enforce Medical Support Obligations

State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.563 – Child Support Enforcement

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Eligibility and Special Tests and Provisions

Amount of Questioned Costs: None

We reviewed 25 child support cases using the Kentucky Automated Support and Enforcement System (KASES). We found five (5) of the cases were incomplete; specifically, the following deficiencies were noted:

Cases A and B did not provide any documentation of follow up to show that the caseworker attempted to establish support or enforce support. There was also no follow up or documentation to indicate if medical support information was obtained.

Cases C, D, and E did not provide any documentation that would indicate that medical support information was established, gathered, or followed up on.

CFC's Division of Child Support has not taken appropriate steps to correct similar problems that were noted during the FY 00 audit.

The Division of Child Support is unable to fulfill its objectives when a caseworker fails to properly process and follow up on child support cases. The division's objectives are to enforce support obligations owed by noncustodial parents, locate absent parents, and obtain child and spousal support. When a caseworker does not process and properly follow up on a case, they are not meeting the above objectives; therefore, the case workers are not providing the proper service to ensure that the child's needs are addressed.

CFR Title 45 Part 303.31 (b) states,

[the IV-D agency must:] (1) Unless the custodial parent and child(ren) have satisfactory health insurance other than Medicaid, petition the court or administrative authority to include health insurance that is available to the noncustodial parent at reasonable cost in new or modified court or administrative orders for support . . .

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC7-41: The Cabinet For Families And Children Should Ensure Every Effort Is Made To Establish And Enforce Medical Support Obligations (Continued)

- (5) Provide the custodial parent with information pertaining to the health policy which has been secured for the dependent child (ren) pursuant to an order obtained in this section.
- (6) Inform the Medicaid agency when a new or modified court or administrative order for child support includes medical support and provide the information . . . to the Medicaid agency when the information is available.
- (7) If health insurance is available to the noncustodial parent at reasonable cost and has not been obtained at the time the order is entered, take steps to enforce the health insurance coverage required by the support order and provide the Medicaid agency with the information . . .

Recommendation

We recommend the Division of Child Support provide more training to caseworkers to ensure that all efforts are made in locating noncustodial parents, establishing support, and enforcing support in accordance with 45 CFR. The agency needs to ensure that all follow up and processing of the cases are adequately documented and that all aspects of the cases are addressed.

All regulations and procedures should be followed to ensure compliance. Caseworkers need to make sure that custodial parents have satisfactory health insurance other than Medicaid and petition the court or administrative authority for custodial parents who do not have satisfactory health insurance. The caseworker also needs to verify that absent parents obtain health insurance coverage and document any reason for not obtaining coverage. They should also inform both the custodial parent and Medicaid when the absent parent has health insurance or CFC obtains health insurance.

Management's Response and Corrective Action Plan

Case A - An email was sent to the responsible worker and a response has not been received to date. A call was made to the Contact Person in the Contracting Official's office however the phone was on voice mail. The supervisor left a message with the information needed for the contact person and asked the worker to contact the supervisor as soon as possible. If this is completed before [close of business] COB today, the supervisor will update this case.

**COMMONWEALTH OF KENTUCKY
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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CFC7-41: The Cabinet For Families And Children Should Ensure Every Effort Is Made To Establish And Enforce Medical Support Obligations (Continued)

Management's Response and Corrective Action Plan (Continued)

Case B - Case was reviewed and discovered this was an inappropriate referral to child support as Family Support considers this an "Intact Family."

Case C - Medical Insurance was not available for the mother as she is incarcerated. Case will be reviewed and enforced for medical as soon as she is available.

Case D - An email was sent to the responsible worker and a response has not been received to date. A call was made to the Contact Person in the Contracting Official's office however the courthouse is closed on Wednesday. A voice mail was left to have the contact person return the supervisor's call with an update on this case as soon as possible.

Case E - Non-custodial parent could not be located. The case was referred to the State Parent Locator Section to pursue location. The worker will monitor the case every 2 weeks and as soon as positive location is returned, the case will be referred to the County Attorney for enforcement action.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

**FINDING 01-CHS9-42: The Drug Rebate Program Should Be More Involved In
The Dispute Resolution Program In Order To Collect More Money**

State Agency: Cabinet for Health Services

Federal Program: CFDA 93.778 – Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Special Tests and Provisions

Amount of Questioned Costs: None

Our prior year report noted there was an outstanding accounts receivable balance of \$79 million for drug rebates. Part of management's response indicated a \$58 million adjustment for an error made in 1992 leaving an outstanding balance of \$21 million. Two million of the \$21 million outstanding balance was from years prior to 2000. In this year's review, we noted that the total amount outstanding is \$30.3 million. Of the \$30.3 million outstanding, \$22.4 million is over 12 months old. The Commonwealth's share of the \$30.3 million calculates to \$6.2 million, which is significant considering budget constraints the state is facing.

For the current year review we noted the following weaknesses:

1. Only the 1997-1998 portion of the \$22.4 million that is over 12 months old went through the resolution process. This was by contract with a private vendor during the audit period.
2. Participation in the Dispute Resolution Program provided by the Center for Medicare/Medicaid Services (CMS) is not as involved as it should be.

The effects can be described as follows:

1. The backdating function of Medicaid allows justifiable expenses to be charged from an earlier period. Waiting extended periods of time to initiate dispute resolutions has become common practice. This practice reduces the likelihood of collection.
2. According to the Team Leader of CMS' Dispute Resolution Program, "KY has only been minimally involved" in the national Dispute Resolution Program meetings and that "would certainly account for any unusually 'high' unpaid/disputed rebate amounts." The Team Leader goes on to say, "those states that are the most active in the DRP [Dispute Resolution Program] are most successful in timely collecting rebates and resolving disputes." Having less of a hands-on approach subjects the state to scrutiny. Collection tactics of private vendors representing other states have been an issue in the past and could have negative impacts.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

**FINDING 01-CHS9-42: The Drug Rebate Program Should Be More Involved In
The Dispute Resolution Program In Order To Collect More Money (Continued)**

The National Drug Rebate Program was established within the Medicaid Assistance Program (MAP) by federal law. One purpose of the program is to recover from drug manufacturers a fee per drug unit dispensed by Medicaid service providers. It is the Department of Medicaid Services' (DMS) responsibility to establish internal controls to properly record, collect, and report all amounts owed to and received by MAP.

Recommendation

We recommend:

1. Management should implement procedures to circumvent negative effects of the backdating process so that resolution processes can go forward within a closer time frame.
2. Management should intensify its efforts in resolving disputes by attending and participating in the Dispute Resolution Program meetings. This ultimately should diminish the need to hire a private vendor to assist in this.

Management's Response and Corrective Action Plan

1. *Providers have 12 months from the date of service in order to bill for a prescription. Previous contract with private vendor only involved completing drug rebate dispute resolutions for 1997 and 1998 and was completed December 31, 2001. Current contract with private vendor will cover 1999 and 2000 and will also involve disputed claims from 1991 through 1996.*
2. *Due to budget restraints, travel has been limited for employees to attend meetings such as Dispute Resolution Program (DRP). We will be seeking approval for a Medicaid Specialist II to attend upcoming DRP conference in Denver, Colorado in June. Our goal is for the Medicaid Specialist II, with her strong pharmacy background and Medicaid experience to become an in house expert in this area. Considering the staffing level of this program (one person), it is highly unlikely that a private vendor would be necessary at this time due to the many billing errors that could occur and the number of drugs that are invoiced.*

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

**FINDING 01-CHS9-42: The Drug Rebate Program Should Be More Involved In
The Dispute Resolution Program In Order To Collect More Money (Continued)**

Auditor's Reply

In nearly all instances, drug rebate dispute resolution could be pursued by the thirteenth month after incurring the charge. The management's response certainly does not offer a good reason why the drug rebate receivable would not be pursued until they are two (2) years of age or more. This approach would appear to reduce the drug rebate receivable outstanding balances.

Participation in the Dispute Resolution Program could result in a high rate of return on a small investment. The federal government provides a 50% administrative match that states can claim for travel expenses related to attending these meetings. This would be a cost-justified expenditure, even when budgets are very tight.

**COMMONWEALTH OF KENTUCKY
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(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

**FINDING 01-CHS10-43: The Cabinet For Health Services Should Reconcile The
Supplementary Medical Insurance Data To The Agency Level Unisys Reports**

State Agency: Cabinet for Health Services

Federal Program: CFDA 93.778 – Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

During our review of control procedures related to Supplementary Medical Insurance (SMI), we discovered that agency personnel are not able to properly reconcile CMS agency level reports to Unisys reports.

Agency procedures indicate that on the 25th of each month or, the next business day, a “Third Party Tape,” which includes all SMI transactions for that month is sent to CMS’s central office in Baltimore. Three (3) or four (4) days prior to the 25th of the month, Unisys sends a preliminary report to its staff to be spot-checked for errors. The staff has a couple days to make any necessary corrections. After any corrections are made, the final report is run by Unisys and sent to the Department of Social Insurance (DSI). DSI then sends this report to CMS in Baltimore.

CMS produces a similar report of SMI claims. This report is produced from CMS’s own database. Upon receipt of the Unisys Report from Kentucky, a comparison is made of the two (2) reports. However, CMS bills from its report and makes no effort to reconcile any differences between the two (2) reports.

The Unisys reports sent to CHS do not match the billing notices from CMS. The purpose of this reconciliation of the two (2) reports is to ascertain whether valid claims have been properly processed against agency records and properly recorded through Unisys, third party administrator for Medicaid claims.

This has been an area of concern with the APA during the last three (3) audits. DMS, along with the federal government and Unisys, is attempting to correct this problem.

If agency personnel are not able to reconcile the CMS reports with Unisys reports, errors and material differences could exist and go undetected. Failure to monitor these accounts could jeopardize the program and future funding.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS10-43: The Cabinet For Health Services Should Reconcile The Supplementary Medical Insurance Data To The Agency Level Unisys Reports (Continued)

A government entity needs an internal control structure which provides controls to ensure compliance with laws and regulations, safeguards assets, checks the accuracy and reliability of accounting data, and promotes operational efficiency. A good internal control structure is essential for the achievement of full accountability, which is the prime issue in today's government. Reconciliations often are key controls.

Recommendation

We recommend Medicaid personnel continue to work with the federal government and Unisys to correct these errors. The agency should consider acquiring the "Third Party Tape" from Baltimore. The "Third Party Tape" can be used to create an exception report, and the errors can be located. After these errors are corrected, CHS management should create an appropriate reconciliation before that responsibility is assigned to a clerk.

Management's Response and Corrective Action Plan

The original intent of this report was not to reconcile the SMI dollars.

The Department for Medicaid Services is reviewing the Medicare Buy-In procedures and will be working with Center of Medicare and Medicaid Services (CMS) and Unisys to implement new procedures to ensure the information is reconciled monthly.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS11-44: The Division Of Substance Abuse Progress Reports For Subrecipient Monitoring Should Be Submitted In A Timely Manner

State Agency: Cabinet for Health Services

Federal Program: CFDA 93.959 – Block Grants for Prevention and Treatment of Substance Abuse

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

For the last two (2) years, we have tested for timeliness of the progress reports completed by Regional Prevention Centers (RPCs). In both years, we have found that timeliness was not being achieved.

In FY 01, we found that eight (8) out of 13 reporting RPCs did not issue reports in a timely manner.

In FY 00 the Division of Substance Abuse made a transition from manual progress reports to electronic reporting. This electronic reporting required activity to be reported on a timely basis. When this change took effect, only five (5) of the 14 Community Mental Health Care Centers (CMHC) submitted activity reports in a timely manner. The APA issued an audit finding pertaining to this matter.

In response to the finding for FY 00, the Management Response and Corrective Action Plan of CHS stated:

The RPC and Champions Reporting Instructions included in all FY 2001 CMHC contracts communicated the following performance expectation:
Timeliness: 95% of all activities will be entered into the Prevention Data Set (PDS) by the end of the month following their completion.

If a center fails to provide any data for two consecutive months, a notice will be sent to the CMHC Executive Director requesting an investigation of the causes of the problem and giving a deadline for corrective action. Payments will be held for non-compliance.

A member of the Department of Mental Health and Mental Retardation informed us that the enforcement of these rules would not actually take place until FY 02.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS11-44: The Division Of Substance Abuse Progress Reports For Subrecipient Monitoring Should Be Submitted In A Timely Manner (Continued)

Without timely reports, appropriate program staff is hindered from monitoring contract compliance and progress made toward meeting the goals and objectives outlined in the annual plan and budget. It also skews performance measures periodically calculated by program staff and hinders on-site reviews. Priority areas and evaluations of prevention performance measures cannot be identified to investigate during an on-site visit.

OMB Circular A-133 section 400 paragraph (d) (3) requires that states “monitor the activities of subrecipients to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.” One way that the Division of Substance Abuse staff monitors compliance is through subrecipient reporting of progress and a review of these progress reports by program personnel. This off-site monitoring provides basis for on-site monitoring of the Substance Abuse Prevention and Treatment Block Grant subrecipients.

Recommendation

We recommend the Division of Substance Abuse enforce all policies and procedures when dealing with progress reports. These reports should be provided timely.

Management’s Response and Corrective Action Plan

In response to the FY 00 audit findings, the Division developed specific policies and procedures for monitoring of timeliness (that would actually be effective for state fiscal year 02). By that time, FY 01 was already over. Monitoring conducted during FY01 took the same approach as FY 00. The Division was deliberately lenient in taking action against Centers for untimeliness due to several reasons: In the past, Centers have submitted the data in paper format and it takes time to work out the problems relating to electronic data submission. The data system was still relatively new and RPC staff still needed significant training and technical assistance and it was also helpful in building positive relationships with Centers regarding data issues.

Please note: The policy cited regarding the holding of payments does not refer to untimely reports but rather to Centers that failed to submit any data report. This situation did not occur in state fiscal year 01.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS11-44: The Division Of Substance Abuse Progress Reports For Subrecipient Monitoring Should Be Submitted In A Timely Manner (Continued)

Management's Response and Corrective Action Plan (Continued)

For use in the remainder of FY 02 and FY 03, the Division will be reviewing and modifying its current policies and procedures for monitoring timeliness. There is some concern that current policies may be more stringent than those applied by other Divisions in the Department and that they may be more labor-intensive than is feasible given the staff resources available for monitoring. The Division will explore the policies and procedures applied throughout the Department with regard to monitoring timeliness, and make policy adjustments as deemed reasonable.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

**FINDING 01-CHS12-45: The Cabinet For Health Services Should Have A System
In Place To Identify Suspended Or Debarred Vendors**

State Agency: Cabinet for Health Services

Federal Program: All Federal Assistance Programs

Federal Agencies: U.S Department of Agriculture,

U.S. Department of Justice,

U.S. Department of Labor,

U.S. Environmental Protection Agency,

U.S. Department of Energy,

U.S. Federal Emergency Management Agency,

U.S. Department of Education,

U.S. Department of Health and Human Services, and

U.S. Corporation for National and Community Services

Pass-Through Entity: Not Applicable

Compliance Area: Procurement and Suspension and Debarment

Amount of Questioned Costs: None

CHS does not have a system in place to identify suspended or debarred vendors, or to prevent them from doing business with state administered federal programs. This has been a prior year audit comment for CHS. However, last year FAC issued a draft policy statement to all state agencies to obtain a certification from successful vendors that they are not debarred from doing business with the federal government prior to award of any contract. CHS has always obtained certification from its subrecipients that they are not suspended or debarred before an award is granted. However, CHS has been deficient in ensuring that procurement contracts of \$100,000 or more are not issued to vendors who are suspended or debarred.

The APA tested all activity with expenditures greater than \$100,000. The results of our tests noted none of these vendors were suspended or debarred. However, CHS has a lack of controls in place to verify whether vendors or potential vendors have been suspended or debarred from transacting business with state administered federal programs. This could result in CHS conducting business with vendors on the federal procurement exclusion list.

Federal Executive Order 12549 Section 5 requires that the federal government compile a list of debarred and suspended vendors. The Common Rule prohibits agencies receiving federal funds from using these vendors. In addition, OMB Circular A-133 Compliance Supplement Part 3, Section I requires the agency to ensure that contractors receiving more than \$100,000 and all subrecipients must certify to the agency that the organization is not suspended or debarred.

**COMMONWEALTH OF KENTUCKY
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FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

**FINDING 01-CHS12-45: The Cabinet For Health Services Should Have A System
In Place To Identify Suspended Or Debarred Vendors (Continued)**

Recommendation

We recommend CHS implement the policy statement drafted by FAC when it is finalized concerning federal procurements of \$100,000 or more.

Management's Response and Corrective Action Plan

The Cabinet for Health Services has worked very diligently with the Finance and Administration Cabinet (FAC) in the development of the debarment policy that is forthcoming. The Cabinet for Health services cannot implement the proposed Debarment Policy until it is finalized by FAC. Therefore, we will take the appropriate action to implement the policy upon its finalization.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-MIL1-46: The Department Of Military Affairs Should Ensure Subrecipients Meet OMB Circular A-133 Audit Requirements

State Agency: Department of Military Affairs
Federal Program: CFDA 83.544 - Public Assistance Grants
Federal Agency: U.S. Federal Emergency Management Agency
Pass-Through Agency: Not Applicable
Compliance Area: Subrecipient Monitoring
Amount of Questioned Costs: None

We performed follow-up procedures for the Department of Military Affairs (MIL) FY 97 finding titled, *The Department of Military Affairs Should Strengthen Procedures for Monitoring Subrecipients*. Based on management inquiry, subrecipient monitoring problems still exist. MIL personnel have not reviewed the audit reports submitted or determined if all entities requiring OMB Circular A-133 audits were audited during FY 01. Audit reports are recorded on the mail log and stamped with the date received, but no additional audit tracking has been done due to understaffing and lack of training. Neither the *Desk Review Guide for Program Audits* nor the *Desk Review Guide for Single Audits* is presently used in the audit review process and MIL personnel have not received training on using the guides.

We also followed up on \$27,753 in questioned costs associated with Bell County's acquisition of five (5) mobile homes purchased to be destroyed. These mobile homes were subsequently returned to the owners instead of being destroyed. In FY 00 Bell County agreed to repay the money over a period of three (3) years; however, no payments have been made.

Failure to adequately track audit reports could result in MIL being unaware of problems noted during audits as well as the corrective action necessary to ensure compliance with CFR Title 44 or the OMB Circular A-133 Compliance Supplement.

The U.S. Federal Emergency Management Agency (FEMA) could withhold the money from Bell County during the present disaster or give the money to another county or program area. (President Bush declared Bell County a disaster area due to flooding on April 5, 2002.)

**COMMONWEALTH OF KENTUCKY
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(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-MIL1-46: The Department Of Military Affairs Should Ensure Subrecipients Meet OMB Circular A-133 Audit Requirements (Continued)

CFR Title 44, Chapter 1, Subchapter A, Part 13.26, Subpart C, states:

- (a) Basic Rule. Grantees and subgrantees are responsible for obtaining audits in accordance with the Single Audit Act Amendments of 1996 (31 U.S.C. 7501-7507) and revised OMB Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations.”
- (b) Subgrantees. State or local governments, . . . , that provide Federal awards to a subgrantee, which expends \$300,000 or more (or other amount as specified by OMB) in Federal awards in a fiscal year, shall:
 - (1) Determine whether State or local subgrantees have met the audit requirements of the Act . . .
 - (2) Determine whether the subgrantee spent Federal assistance funds provided in accordance with applicable laws and regulations. This may be accomplished by reviewing an audit of the subgrantee made in accordance with the act . . . , or through other means (e.g., program reviews) if the subgrantee has not had such an audit;
 - (3) Ensure that appropriate corrective action is taken six months after receipt of the audit report in instance of noncompliance with Federal laws and regulations:
 - (4) Consider whether subgrantee audits necessitate adjustment of the grantee’s own records . . .

In order to adhere to the single audit act amendments, the Compliance Supplement states: “Determine whether the pass-through entity ensured required audits are performed and required appropriate corrective action on monitoring and audit findings.”

The FY 97 audit report for Bell County states the grant agreement required destruction of the mobile homes acquired through the Hazard Mitigation Program Grant. The mobile homes were not destroyed.

Recommendation

We recommend:

- Management hire and train one additional employee whose main job duty is tracking and reviewing audit reports.
- Management should meet with the Bell County Judge/Executive and FEMA representatives while on site of the current disaster and discuss the repayment of the \$27,753.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-MIL1-46: The Department Of Military Affairs Should Ensure Subrecipients Meet OMB Circular A-133 Audit Requirements (Continued)

Management's Response and Corrective Action Plan

The Director of the Kentucky Division of Emergency Management (KyEM) discussed with the Bell County Judge Executive the requirement to refund the amount in question (\$27,753). The County Judge Executive after consulting with the County Treasurer has agreed to make a lump sum refund to the Division. The Division has been advised that this payment was submitted for Fiscal Court action on April 29, 2002.

The Division cannot, under prevailing financial and staffing constraints, hire an additional employee to track and review audit reports. However the Division will take appropriate action; specifically, the Division will designate an employee with this responsibility and establish procedures to fulfil this requirement.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CPE1-47: The Council On Postsecondary Education Should Establish A Tickler System To Ensure Timely Completion Of The Council's Obligations

State Agency: Council On Postsecondary Education

Federal Program: CFDA 84.281 – Eisenhower Professional Development State Grants

Federal Agency: U.S. Department of Education

Pass-Through Agency: Not Applicable

Compliance Area: Period of Availability of Federal Funds and Subrecipient Monitoring

Amount of Questioned Costs: None

Funds designated to be reimbursed from the Year 14 award (award number S281B980017) had to be drawn down under the Year 15 award (award number S281B990017) since the federal agency had closed out the Year 14 award. CPE attempted to request reimbursement from the Year 14 award for payments made to subgrantees during the year ended June 30, 2001 for expenses of the subgrantees through September 30, 2000, with the closeout period ending on December 31, 2000. By December 31, 2000, all of the administrative actions and required work applicable to the Year 14 award should have been completed. These items were not completed in a timely manner.

Funds designated to be reimbursed from the Year 14 award were thus reimbursed from the Year 15 award. Subsequently the funds remaining under the Year 15 award are not sufficient to cover the projects designated to be reimbursed under the Year 15 award.

The procedures in place to ensure that the administrative actions and required work as applicable to the Year 14 award were finalized prior to December 30, 2000 were not followed.

Recommendation

CPE should establish a tickler system to ensure timely completion of CPE's obligations under the program.

Management's Response and Corrective Action Plan

The Council staff agrees with the finding and has corrected the problem. In researching this issue, the Council staff also determined that the Year 12 award had to be reopened to resolve this issue. The United States Department of Education agreed to reopen the Year 12 award and the adjustment was made. The Council staff has now recovered all federal funds from the Eisenhower program. The Council has created and filled a new staff accountant position whose responsibilities include the administration of the federal awards including timely draw of federal funds.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CPE2-48: The Council On Postsecondary Education Should Implement Additional Follow Up Procedures To Ensure That Required Information Is Requested If Not Received In A Timely Manner

State Agency: Council On Postsecondary Education

Federal Program: CFDA 84.281 – Eisenhower Professional Development State Grants

Federal Agency: U.S. Department of Education

Pass-Through Agency: Not Applicable

Compliance Area: Period of Availability of Federal Funds and Subrecipient Monitoring

Amount of Questioned Costs: None

Per review of the client maintained “Final Report Status” listing, one (1) of the 13 Year 15 Final Reports due July 31, 2001, was not received in a timely manner. Per review of the client maintained “Interim Report Status” listing, one (1) of the 14 Year 16 Interim Reports due July 31, 2001, was not received in a timely manner.

Per review of the client maintained “Audit Review Master Checklist” listing, the June 30, 2000 audited financial statements for three (3) of the 11 Year 14 projects and two (2) of the 10 Year 15 projects were not received in a timely manner. CPE should have, at the very latest, received these audited financial statements by March 31, 2001.

CPE was not able to verify that the federal funds are being expended as intended.

The procedures in place did not ensure the receipt of such information in a timely manner.

Recommendation

CPE should implement additional follow-up procedures to ensure that the required information is requested if not received in a timely manner.

Management’s Response and Corrective Action Plan

The Council staff agrees with the finding and currently has received and reviewed all required information for years 14 and 15. The Council staff has developed and implemented a tickler system to ensure that all grant recipients are notified when information is due and whether or not the information has been received.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-TC1-49: The Transportation Cabinet Should Strengthen Controls To Ensure Accurate Reporting On The Schedule Of Expenditures Of Federal Awards

State Agency: Transportation Cabinet
Federal Program: All Federal Assistance Programs
Federal Agency: U.S. Department of Energy and
U.S. Department of Transportation
Pass-Through Agency: None
Compliance Area: None (Internal Controls)
Amount of Questioned Costs: None

During the audit of the Transportation Cabinet's SEFA, the following were noted:

- The SEFA was not reconciled to the Management Reporting Database (MRDB) prior to being submitted to the APA.
- Procedures were not in place to ensure that all pass-throughs were accurately reported on the SEFA or in the MRDB.

There were similar problems noted in the audit of the Transportation Cabinet's SEFA in the FY 00 audit as well, and those were reported to the Transportation Cabinet as an other matter comment. As a result of that comment, Transportation stated in the future, the supervisor of the financial reporting section would be in charge of preparing the reconciliation, which would be reviewed and approved by the general accounting branch. We have not seen improvement in the FY 01 SEFA.

When the SEFA is not reconciled to MRDB, there could be several unfavorable results:

- It leaves open the possibility of incorrect information being reported in MRDB and/or incorrect or inaccurate information presented in the SEFA.
- Information that should be presented on the SEFA may be omitted; pass-throughs of federal money may be omitted.
- Many errors could go undetected until audit procedures are performed, thus, increasing the work of the auditors and agency personnel due to the need for increased audit procedures and the need for numerous revisions and corrections.
- The information presented in MRDB could be reported in an inconsistent manner, thus making reconciliation procedures difficult to perform.
- The SEFA may not correspond with other agency schedules reporting pass-throughs to and from the Transportation Cabinet.
- Pass-throughs may not be differentiated from other receipts and expenditures.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-TC1-49: The Transportation Cabinet Should Strengthen Controls To Ensure Accurate Reporting On The Schedule Of Expenditures Of Federal Awards (Continued)

APA SEFA instructions state:

Information contained in the schedule should be reconciled to the Management Reporting Database (MRDB), an extract of the Management Administrative Reporting System (MARS) information, with documentation of the reconciliation retained. This will ensure that the schedule, although based on agency records both manual and automated, will agree to the official accounting records of the Commonwealth, which will have been agreed to the Commonwealth's general-purpose financial statements.

If your agency does not operate through MARS, the schedule should be reconciled to the agency accounting system supporting your agency's financial statements.

This reconciliation should encompass both receipts and expenditures, and should be done on a grant-by-grant basis, if possible.

The Transportation Cabinet representation letter dated November 13, 2001, asserts, "We have reconciled information contained in the Schedule of Expenditures of Federal Awards – cash programs to the Management Administrative Reporting System and Management Reporting Database."

APA instructions also state:

Passed through from other agencies (previously called transfers-in) (including revenue redistributions) should consist of federal moneys received from other federal grants (either from inside the agency or from another state agency) to fund federal expenditures. When an agency is a subrecipient of another state agency, those moneys received should be shown in this column. If you are not able to determine if you are considered a subrecipient or a vendor, it may be necessary to contact another state agency to determine their treatment of the transaction(s). All amounts in this column must be explained in the Notes.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-TC1-49: The Transportation Cabinet Should Strengthen Controls To Ensure Accurate Reporting On The Schedule Of Expenditures Of Federal Awards (Continued)

Passed through to other agencies (previously called transfers-out) (including revenue redistributions) should consist of moneys distributed from the grant to other federal grantors (either to inside the agency or to another state agency) to fund federal expenditures. Passed through amounts between grants with the same agency must agree. Payments made to state agency subrecipients, except to state universities, would be shown in this column. Report federal moneys to a state university as an expenditure in Column H. All amounts shown in this column must be explained in the Notes.

Recommendation

We recommend the Transportation Cabinet reconcile the SEFA to MRDB prior to being submitted to the APA to ensure an accurate and complete schedule is submitted and to ensure the information reported in MRDB is accurate, complete, and presented in a consistent manner. We also recommend the Transportation Cabinet implement procedures to ensure all pass-throughs are accurately reported on the SEFA and will allow pass-throughs to be differentiated from other receipts and expenditures in MRDB/MARS. Further, we recommend the Transportation Cabinet staff charge grant expenditures to correct CFDA numbers in MARS.

Management's Response and Corrective Action Plan

Prior to the submission of the SEFA, we reconciled to MRDB based on PBU [Program Budget Unit]. The APA wanted us to reconcile the SEFA by CFDA #, which we subsequently did. Prior to submission of the FY 02 SEFA to the APA, the section supervisor will add to her procedures a reconciliation by CFDA #.

The pass-through in question was for \$2,332 from Natural Resources. Our discussions with the APA led us to believe that this matter had been dropped due to immateriality. However, to ensure that does not occur in the future, we have assigned our Internal Policy Analyst II to immediately start performing a monthly review and analysis of all federal receipts and transfers. This on-going review will occur each month after hard close and should help us identify any moneys received that are pass-throughs. Once identified we will contact the paying agency and determine proper recording.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-TC1-49: The Transportation Cabinet Should Strengthen Controls To Ensure Accurate Reporting On The Schedule Of Expenditures Of Federal Awards (Continued)

Management's Response and Corrective Action Plan (Continued)

When we perform the reconciliation noted above, this procedure should detect any expenditures not charged to a CFDA #. Also, we will immediately instruct the Federal Billing Section Branch Manager to make adding the CFDA # part of their process.

Auditor's Reply

During the performance of audit procedures regarding the receipt and expenditure reconciliations for the SEFA, it was noted that there were instances in which several CFDA numbers share a single PBU. It was also noted that a CFDA number may contain several different PBUs within that single CFDA number. The reconciliation performed by the auditors was based on PBU due to problems noted in the prior and current audits with the coding of CFDA numbers in MARS. There were errors detected when we attempted to reconcile by PBU. Reconciling by PBU only, will not provide an accurate presentation of the true federal receipts and expenditures incurred by specific federal programs. For example, when several CFDA numbers show a single PBU, one program may overspend and this problem would go undetected. This occurs because another program may underexpend and it would balance out. Therefore the accuracy of the individual CDFA expenditure amounts is questioned.

Secondly, the issue regarding Natural Resources was dropped due to the immateriality of the amount only and no changes were recommended for the agency level SEFA. However, a control weakness still existed. Strong internal controls were not present to ensure that all pass-throughs were reported.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD7-50: The Department For Training And ReEmployment Did Not Reconcile Financial Status Reports To MARS

State Agency: Cabinet for Workforce Development
Federal Program: CFDA 17.255 – Workforce Investment Act
Federal Agency: U.S. Department of Labor
Pass-Through Entity: Not Applicable
Compliance Area: Reporting
Amount of Questioned Costs: None

Financial Status Reports (FSR) for Local Administration, Local Adult, Local Dislocated Worker, and Local Youth programs cannot be traced to MARS. These FSRs agree to Department for Training and ReEmployment's (DTR) grant accounting system, which is compiled from Local Workforce Investment Areas (LWIA) expenditure reports. The expenditure data recorded in MARS reflects only amounts reimbursed to the LWIAs and has not been updated to reflect actual expenditures in the appropriate categories—administration, adult, dislocated worker, or youth programs.

Since WIA expenditures of LWIAs have not been updated in MARS to accurately reflect actual expenditures by the LWIAs the users of the FSRs do not get an accurate picture of activities occurring in WIA programs.

Proper internal controls dictate the agency maintain adequate supporting documentation for reports submitted to the federal government. MARS is the official record of expenditures. Further, agency procedures indicate that this update of MARS should occur at least quarterly.

Recommendation

We recommend DTR follow procedures to comply with the quarterly update of MARS. DTR should fully utilize the capabilities of MARS to track grant expenditures so that the state's official accounting system fully supports expenditures as submitted in federal reports. Journal vouchers could be used to "move" expenditures from the wire-transfer activity code or object code to a separate category for the expenditures as reported by LWIA expenditure reports on a quarterly basis.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD7-50: The Department For Training And ReEmployment Did Not Reconcile Financial Status Reports To MARS (Continued)

Management's Response and Corrective Action Plan

Although MARS cannot fully reflect actual expenditures in the appropriate categories, DTR has already implemented corrective action to improve the process. Currently, Youth, Adult, and Dislocated Worker funds are assigned separate project numbers and corrections are made quarterly to move expenditures to the appropriate project. Local areas draw their funds under the appropriate categories and corrections are made quarterly by a WIA Fiscal Officer to reflect the total reported expenditures.

DTR agrees that delineating expenditures by administration and program as well as Statewide Administration and Rapid Response could more accurately reflect actual expenditures. A WIA Fiscal Officer will investigate this possibility with Fiscal Services to establish the most effective means of implementing this change by May 31, 2002. The system will not provide a completely accurate picture since the Local Areas report accrued expenditures and MARS only reflects reimbursements, but the reported expenditures will be more clearly delineated.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD8-51: The Department For Training And ReEmployment Did Not Reconcile Subrecipient Reports

State Agency: Cabinet for Workforce Development
Federal Program: CFDA 17.255 – Workforce Investment Act
Federal Agency: U.S. Department of Labor
Pass-Through Entity: Not Applicable
Compliance Area: Reporting
Amount of Questioned Costs: None

While conducting tests of subrecipient cash reconciliation reports, the auditor found three (3) instances where reported expenditure or drawdown amounts did not trace to LWIA supporting expenditure documentation for the reconciliation or DTR's drawdown record. It did not appear that the DTR-38 had been reviewed for errors. In addition, the auditor repeatedly found instances where the subrecipient had issued multiple "corrected" or final reports for a specific reporting period.

Failure to reconcile subrecipient invoices on a timely basis could result in undetected errors and potentially the issuance of inaccurate federal reports and reimbursement of incorrect or unsubstantiated amounts. In addition, this could prevent the agency from reconciling subrecipient audited financials to the agency's records as required by OMB Circular A-133.

The submission of numerous reports for an accounting or reporting period can result in confusion and unnecessarily complicate the process of reconciling expenditure reports.

Proper internal control dictates that subrecipient reports should be reviewed for accuracy and where possible amounts traced to supporting documentation to detect errors and prevent inaccurate information from being used to compile federal reports.

Recommendation

We recommend DTR strengthen internal controls over subrecipient monitoring to ensure that reconciliations are properly reviewed for errors and corrections are properly documented.

We also recommend DTR discourage the submission of multiple reports and instead require subrecipients to incorporate changes into subsequent expenditure reports. While it may be necessary for fourth quarter reports to be resubmitted due to audit findings, etc., it should be possible to make other changes in subsequent reports.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD8-51: The Department For Training And ReEmployment Did Not Reconcile Subrecipient Reports (Continued)

Management's Response and Corrective Action Plan

DTR has already addressed this issue and implemented the following corrective actions:

- 1. LWIA fiscal staff have been instructed to avoid filing amended financial reports whenever possible unless the amendments are the result of audit corrections.*
- 2. Upon receipt of the DTR-38 an Internal Policy Analyst reviews the expenditure information to verify that the individual grant reports support the DTR-38.*
- 3. A WIA Fiscal Officer reviews the drawdown information to verify that it reflects the information in DTR internal records and works with LWIA staff to correct any discrepancies.*
- 4. DTR fiscal staff provide technical assistance to LWIA's to improve the accuracy and consistency of information reported on the DTR-38.*

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD9-52: The Department For Training And ReEmployment Did Not Monitor Timesheets To Ensure The Correct Project Code Was Being Charged

State Agency: Cabinet for Workforce Development
Federal Program: CFDA 17.255 – Workforce Investment Act
Federal Agency: U.S. Department of Labor
Pass-Through Entity: Not Applicable
Compliance Area: Allowable Costs
Amount of Questioned Costs: None

Grant project codes on some timesheets tested did not agree with the Uniform Personnel and Payroll System (UPPS) reports. Of the 28 employees charging time to WIA the auditor selected 15 employees for testing. Various pay periods were observed for the employees chosen and the auditor found four (4) deficiencies during testing.

WIA has six (6) grants open. There were no indications from our testing these grants were overcharged due to the improper recording of project codes on timesheets. However, if the wrong project is coded it is possible to over-expend or charge to a closed grant.

Per OMB Circular A-87:

[c]harges to federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit . . . Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification . . .Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports . . .

These reports must account for the total activity for which each employee is compensated.

Recommendation

The project code on each timesheet should be updated each pay period so that each grant is properly charged. This will also ensure the payroll administrator will record the correct payroll data into the system.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD9-52: The Department For Training And ReEmployment Did Not Monitor Timesheets To Ensure The Correct Project Code Was Being Charged (Continued)

Management's Response and Corrective Action Plan

We agree with the recommendation for improvement. In the future we will pay closer attention to the project codes for grants on timesheets to ensure that they agree with UPPS reports and that each grant is properly charged.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD10-53: The Division Of Unemployment Insurance Is Not Reconciling Accounts Receivable To Ensure Federal Reports Are Accurate

State Agency: Cabinet for Workforce Development

Federal Program: CFDA 17.225 – Unemployment Insurance

Federal Agency: U.S. Department of Labor

Pass-Through Entity: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

The Employment and Training Administration (ETA) 581 form is inaccurately stated due to double adjustments made from noncompliance with agency procedures. The agency is not complying with the set procedures to audit the processed payments before making adjustments. Tax data is entered from the employer quarterly reports. During the process of auditing these reports, the agency will determine that the information posted to the accounting system is in error. The erroneous data will be deleted and the correct information entered. These transactions are not reflected in the accounts receivable activity report, which is the source document for the ETA 581. Auditing of reports is not being completed prior to the end of the quarter when the source document is generated. Thus, the accounts receivable activity report used as a source document for the ETA 581 is not a reliable indicator of actual receivables.

The magnitude of this discrepancy could not be calculated due to the fact that the actual population of double adjustments could not be determined. It is impossible to ascertain which records have been double adjusted and which records have not. Thus it is impossible to state whether agency data is accurate or not for reporting.

Source data for the federal reports is inaccurate, due to unreliable agency reports. Therefore, it is impossible for the federal government to have an accurate figure of what employers actually pay into the Kentucky Unemployment Insurance program.

Proper internal controls dictate that accurate information should be presented when preparing and transmitting federal reports. Thus, reports can be supported by valid and accurate supporting documentation.

Recommendation

We recommend controls be implemented to ensure double adjustments are not recorded. The agency needs to ensure audits are performed in a timely manner to prevent duplication of adjustments. It is understood that the agency has made progress to solve this problem and we recommend the agency continue with its corrective action plan.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD10-53: The Division Of Unemployment Insurance Is Not Reconciling Accounts Receivable To Ensure Federal Reports Are Accurate (Continued)

Management's Response and Corrective Action Plan

The Department acknowledges that the findings are correct. The adjustments are being made on reports that have not been audited. The system will be modified so that no adjustments can be made until the quarterly report has been audited. Employees will be unable to call up any report until the audit is completed. This will correct the adjustment problem. The Department also acknowledges that the report audit process is not being completed prior to the end of the quarter when the source document is generated. To ensure that it will not reoccur, the Department will dedicate sufficient report audit staff to complete a timely audit. Further, the Department will ensure that the accounts receivable activity will be accurately reported hereafter. The Department will be in full compliance by the next audit cycle in January 2003.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD11-54: The Division Of Unemployment Insurance Has Not Performed The 1999 Certification Of Employer Contributions

State Agency: Cabinet for Workforce Development
Federal Program: CFDA 17.225 – Unemployment Insurance
Federal Agency: U.S. Department of Labor
Pass-Through Entity: Not Applicable
Compliance Area: Reporting
Amount of Questioned Costs: None

Each state is required to annually certify for each taxpayer (employer) the total amount of contributions required to be paid for the calendar year and the amounts and dates of such payments. This is done by each state performing a match of employer tax payments with credit claimed for these payments on the employer's Internal Revenue Service (IRS) 940 Federal Unemployment Tax Administration (FUTA) tax form. The IRS is not able to provide information to the Department of Unemployment Insurance (UI) until September or November of the following year. So, for FY 01, UI should be certifying for calendar year 1999. We requested the trial balance of employer's accounts and the 1999 certification. None of this documentation was provided to us because it was still being processed. Therefore, the annual IRS 940 FUTA certification (match) has not been performed for 1999.

The state is not able to report to each taxpayer on a timely basis the total amount of contributions so that they can be allowed the credit against the FUTA tax.

26 CFR section 31.3302(a)-3(a) requires the state to provide this annually. Also proper internal controls dictate that procedures should be in place so program requirements can be met on a timely basis.

Recommendation

We recommend that controls be implemented to ensure the annual IRS FUTA match is performed.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

**FINDING 01-CWD11-54: The Division Of Unemployment Insurance Has Not
Performed The 1999 Certification Of Employer Contributions (Continued)**

Management's Response and Corrective Action Plan

The Agency agrees with the auditor's recommendations and the Federal Certification for 2003 will be timely. The new Trial Balance process is now in place and the trial balances for 2000 have been completed. The certification is currently being run for 1999 that should have been completed by Feb. 28, 2001. The IRS is aware of the problems the Commonwealth has encountered. We should not have future problems in running the Federal Certification in a timely manner.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD12-55: The Department For Training And ReEmployment Did Not Correctly Report Some Amounts For JTPA Closeout

State Agency: Cabinet for Workforce Development

Federal Program: CFDA 17.250 – Job Training Partnership Act

Federal Agency: U.S. Department of Labor

Pass-Through Entity: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

During tests of Job Training Partnership Act (JTPA) closeout reports, we found the following amounts were incorrectly reported on the Job Training Partnership Act Quarterly Status Report (JQSR):

- PY 1998 JQSR Incentive Funds Expended (Non-Additive) (line 24)
- PY 1998 JQSR Title II-C (lines 19-23) Amounts reported are not supported by the Service Delivery Area (SDA) expenditure spreadsheets.

DTR has not developed written procedures for the preparation, review, and approval of federal reports. As a result, it is difficult for someone other than the preparer to recreate the amounts reported. In addition, errors that could be detected in the review process are not corrected before submission.

We were unable to verify the accuracy of the above amounts submitted to the United States Department of Labor (DOL) in the JTPA closeout reports. Also, DOL is not able to determine if JTPA was closed out properly.

The agency's lack of written policies for the preparation, review, and approval of federal reports resulted in inaccuracies in the JTPA report submitted to the DOL.

Good internal control dictates that the accounting records support federal reports and written procedures be fully utilized.

Recommendation

We recommend the following:

- Reports be corrected as necessary and be available for review with adequate supporting documentation in subsequent audits.
- Development of written procedures for the preparation, review, and approval of federal reports.
- Supporting documentation for reports be readily available and adequately referenced.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD12-55: The Department For Training And ReEmployment Did Not Correctly Report Some Amounts For JTPA Closeout (Continued)

Management's Response and Corrective Action Plan

DTR agrees with the recommendations for improvement and has already implemented procedures to correct this situation. Federal report information is prepared by each member of the fiscal staff and reviewed for accuracy prior to submission. The WIA Fiscal Officer is ultimately responsible for submission of the reports and the inclusion of supporting documentation with each report. The reports identified in this RCW will be amended and filed before May 31, 2002 and maintained with the appropriate supporting documentation. Written procedures for the preparation and submission of federal reports will be completed and implemented prior to May 31, 2002.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weaknesses and/or Material Instances of Noncompliance:

FINDING 01-CWD13-56: The Department For Training And ReEmployment Did Not Follow Up On Subrecipient Findings In A Timely Manner

State Agency: Cabinet for Workforce Development

Federal Program: CFDA 17.255 – Workforce Investment Act

Federal Agency: U.S. Department of Labor

Pass-Through Entity: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

During the FY 01 audit, we tested the audit log maintained by the DTR to track subrecipient monitoring related to the required audits of subrecipients. During this review, we noted several incidences, in which DTR did not obtain, review, reconcile, and resolve LWIA audits in a timely manner.

Furthermore, we noted that this is a repeat finding, which has been noted since the FY 96 audit of the JTPA program as an other matter comment and was upgraded to a reportable condition in FY 99. The agency's prior year corrective action plan indicated that the agency would take the necessary steps to strengthen controls over monitoring of subrecipient audits. However, our testing indicated that most deficiencies within the audit monitoring system had not been corrected and the plan had not been implemented.

We noted the following deficiencies:

- Four (4) incidences in which DTR did not obtain the LWIA audit reports in a timely manner. The receipt of the audit reports in an untimely manner delays the entire resolution process. It also increases the likelihood that subrecipient weaknesses noted in the audit continue for a longer period of time since they are not being addressed.
- Three (3) incidences in which DTR did not resolve subrecipients' audit report findings in a timely manner. According to the Agency Guidelines and the federal regulations for WIA, the agency has 180 days to resolve these matters. Again, untimely resolution of audit findings increases the likelihood that subrecipients' weaknesses continue for a longer period of time since they are not being addressed.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD13-56: The Department For Training And ReEmployment Did Not Follow Up On Subrecipient Findings In A Timely Manner (Continued)

- Two (2) incidences in which DTR did not receive a cognizant agency letter determining whether the subrecipient audits were in compliance with OMB Circular A-133. The agency did complete a technical review of eight (8) of the 10 subrecipient FY 00 audits, which APA auditors have accepted as satisfying this requirement. However, two (2) technical reviews were not documented. Adequate review of the audit is necessary to obtain any other assurance that subrecipients complied with OMB Circular A-133, as required by the regulations. We noted that DTR completed the technical reviews using the “SCX-18: Single Audit Reports Checklist” as recommended in the prior year for those reviews completed.
- Ten incidences in which the agency’s records were not reconciled to the LWIA’S audited financial statements. This should be performed to ensure the audited financial statements agree with the amounts reported in the agency’s grant accounting records. Unreconciled financial statements lead to the potential for federal reporting that does not agree to the financial statements on which an opinion has been given.
- Deficiencies noted during the FY 00 audit were not corrected.

Without timely monitoring of subrecipient audits the funding agency cannot determine whether the subrecipient has audit findings or questioned costs. The funding agent should be aware of any problems found by the subrecipient’s auditors and see that the corrective action plans are implemented.

OMB Circular A-133 states that the funding agency should be sent a copy of the audit report “within the *earlier* of 30 days after [the subrecipient’s] receipt of the auditor’s report(s), or 9 months after the end of the audit period.” This requirement is also outlined in DTR’s Audit Resolution Guide. This requirement is in effect for fiscal years beginning after June 30, 1998; previously the requirement was 13 months. [OMB Circular A-133 Subpart B, Sec 235 (c) (1).]

The WIA regulations state: “The Governor is responsible for resolving findings that arise from the State’s monitoring reviews, investigations and audits (including OMB Circular A-133 audits) of subrecipients.” [20 CFR 667.500 (a) (1) and (2).]

OMB Circular A-133 states the pass-through entity should “consider whether subrecipient audits necessitate adjustment of the pass-through entity’s own records.” [OMB Circular A-133; Subpart D Sec 400 (d) (6).]

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD13-56: The Department For Training And ReEmployment Did Not Follow Up On Subrecipient Findings In A Timely Manner (Continued)

Further, OMB Circular A-133 states that pass-through entities are responsible for issuing a management decision on audit findings of subrecipients within six months after receipt of the audit finding. [OMB Circular A-133; Subpart D Sec 400 (d) (5)] If corrective action has not been completed at that time, a timetable for follow-up may be included. [OMB Circular A-133; Subpart D Sec 405 (a)]

Recommendation

We recommend CWD and DTR implement procedures to ensure compliance with the WIA regulations, OMB Circular A-133 and the DTR Guidelines regarding audit resolutions of subrecipients.

Management's Response and Corrective Action Plan

DTR agrees that the corrective action plans submitted in regard to the finding on the subrecipient audit reports has not been fully implemented since FY 96.

The primary reason that full implementation has not occurred is the lack of staff resources available to perform this function. This function is the current responsibility of staff assigned to the Fiscal Section in the Financial and Program Operations Branch. This Section's main duties and responsibilities are composed of grant management, agency accounting, federal reporting and contract payments. The monitoring of subrecipient audit reports function received a limited amount of staff time due to the critical nature of the section's main duties.

To remedy this situation, DTR has reassigned the duties and responsibilities for monitoring of subrecipient audits to the Program Compliance and Support Branch. This reassignment will ensure that additional staff resources are available to perform the function. The Financial and Program Operations Branch will provide technical assistance to the other branch by training staff to perform the review function and assisting with the reconciliation of the audited financial statements to DTR records. We expect this training to be completed by the end of June 2002. This transition of duties and responsibilities will begin with the Fiscal Year 2001 subrecipient audit reports.

DTR will also initiate an effort to reconcile the LWIA audit financial statements to DTR records beginning with FY 2001 and going back to FY 96, the initial period cited by the auditors as to when the problem began.

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD14-57: The Department For Training And ReEmployment Has Not Fully Implemented Its Corrective Action Plan To Monitor Subrecipient Reports

State Agency: Cabinet for Workforce Development
Federal Program: CFDA 17.255 – Workforce Investment Act
Federal Agency: U.S. Department of Labor
Pass-Through Entity: Not Applicable
Compliance Area: Subrecipient Monitoring
Amount of Questioned Costs: None

DTR has failed to implement the corrective action plans submitted in each of the past five (5) years with regards to monitoring subrecipient audit reports. The agency has repeatedly failed to fully implement the corrective action plans submitted. While there have been improvements in the number of exceptions, we still conclude that the agency's corrective action plan for fiscal year ended June 30, 2000, for subrecipient monitoring of LWIA audit reports is materially misrepresented.

Without timely monitoring of subrecipient audits, the funding agency cannot determine whether the subrecipient has audit findings or questioned costs. The funding agent should be aware of any problems found by the subrecipient's auditors and see that the corrective action plans are implemented.

OMB Circular A-133 states that the funding agency should be sent a copy of the audit report "within the *earlier* of 30 days after [the subrecipient's] receipt of the auditor's report(s), or 9 months after the end of the audit period." This requirement is also outlined in DTR's Audit Resolution Guide. This requirement is in effect for fiscal years beginning after June 30, 1998; previously the requirement was 13 months. [OMB Circular A-133 Subpart B, Sec 235 (c) (1).]

The WIA regulations state: "The Governor is responsible for resolving findings that arise from the State's monitoring reviews, investigations and audits (including OMB Circular A-133 audits) of subrecipients." [20 CFR 667.500 (a) (1) and (2).]

OMB Circular A-133 states that the pass-through entity should consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records. [OMB Circular A-133; Subpart D Sec 400 (d) (6).]

Further, OMB Circular A-133 states that pass-through entities are responsible for issuing a management decision on audit findings of subrecipients within six months after receipt of the audit finding. [OMB Circular A-133; Subpart D Sec 400 (d) (5)] If corrective action has not been completed at that time, a timetable for follow-up may be included. [OMB Circular A-133; Subpart D Sec 405 (a)]

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CWD14-57: The Department For Training And ReEmployment Has Not Fully Implemented Its Corrective Action Plan To Monitor Subrecipient Reports (Continued)

Recommendation

We recommend CWD and DTR implement procedures to ensure compliance with the WIA regulations, OMB Circular A-133 and the DTR Guidelines regarding audit resolutions of subrecipients.

Management's Response and Corrective Action Plan

See the response at 01-CWD13-56.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 00	00-CFC-1	The Cabinet For Families And Children Should Monitor The Division Of Child Support Enforcement’s Contract With Tier Technologies	N/A	0	Resolved during FY 01.
FY 00	00-CFC-2	The Cabinet For Families And Children Should Implement Cash Controls To Strengthen The Collections Process At Tier Technologies	N/A	0	Resolved during FY 01.
FY 00	00-CFC-3	The Cabinet For Families And Children Should Implement A System For Identifying Specific Expenditure Types Within MARS	N/A	0	Resolved during FY 01.
FY 00	00-CFC-13	The Cabinet For Families And Children Should Track All EBT Cards Issued At DCBS Local Offices	10.561	0	Resolved during FY 01.
FY 00	00-CFC-14	The Cabinet For Families And Children Should Reconcile FNS-46 Reports Before They Are Submitted To USDA	10.561	\$105,965	Refiled reports resolved questioned costs during FY 01. This finding is resolved.
FY 01				(105,965)	
Total Questioned Costs				<u>\$0</u>	
FY 00	00-CFC-15	The Cabinet For Families And Children Should Improve Access Security Controls For Manual Input Of EBT – Food Stamp Records To The EDGE System	10.561	0	Resolved during FY 01.
FY 99	99-CFC-31	The Cabinet For Families And Children Should Strengthen Controls In Preparing The Schedule Of Expenditures Of Federal Awards	N/A	0	Resolved during FY 01.

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 99	99-CFC-32	The Cabinet For Families And Children Should Reimburse The U.S. Department For Health And Human Services For Improper Payments	93.596	\$105,421	Resolved during FY 01.
FY 00				(105,421)	
Total Questioned Costs				<u>\$0</u>	
FY 99	99-CFC-35	The Department For Disability Determination Should Improve Program Modification Procedures	N/A	0	Resolved during FY 01.
FY 97	97-CFC-42				
FY 98	98-CFC-18	The Cabinet For Families And Children Should Improve Efforts To Enforce The Policies In Relation To The State Administrative Matching Grants For The Food Stamps Program	10.561	0	Due to improvements, this finding is downgraded to an other matter for FY 01. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 98	98-CFC-21	The Cabinet For Families And Children Should Integrate Systems To Improve The Claims Process For The TANF Program	93.558	\$0	Due to improvements, this finding is downgraded to an other matter for FY 01. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 97				23,175	
FY 01				(23,175)	
Total Questioned Costs				<u>\$0</u>	
FY 98	98-CFC-24	The Cabinet For Families And Children Should Maintain All Billing And Eligibility Documentation To Support Payments To Families Receiving Assistance From The Child Care And Development Fund	93.596	\$0	Resolved during FY 01.
FY 99				1,847	
FY 01				(1,847)	
Total Questioned Costs				<u>\$0</u>	

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 98	98-CFC-26	The Cabinet For Families And Children Should Ensure That Complete Records Are Maintained For TANF Recipients	93.558	\$0	Due to improvements, this finding is downgraded to an other matter for FY 01. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 97				1,290	
FY 01				(1,290)	
Total Questioned Costs				<u>\$0</u>	
FY 00	00-FAC-4	The Office Of Financial Management Should Reconcile MARS And CAMRA Monthly To Ensure Agreement Between The Two Systems	N/A	0	Resolved during FY 01.
FY 00	00-FAC-7	The Finance and Administration Cabinet Should Monitor Cash Management Improvement Act Eligible Projects To Ensure They Are Properly Recorded In MARS	N/A	0	Exceptions were again noted during the review of the CMIA Eligibility flag for FY 01. However, significant improvement in the classifications of clearance patterns was noted since FY 00. This comment is downgraded to other matters for FY 01. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 99	99-FAC-4	The Division Of Statewide Accounting Services Should Ensure Only Authorized Budgetary And Transaction-Specific Overrides Are Made To System Tables	N/A	0	Due to noted improvements, this finding was downgraded to a verbal comment in FY 01. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 99	99-FAC-6	The Division of Statewide Accounting Services Should Follow Established Procedures To Ensure That Only Authorized Changes Are Made To System Tables	N/A	0	Due to noted improvements, this finding was downgraded to a verbal comment in FY 01. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 99	99-FAC-7	The Division Of Contracting And Administration Should Improve Internal Controls Relating To The Use Of Change Orders In Construction Contracts	N/A	0	Resolved during FY 01.
FY 99	99-FAC-8	The Division Of Contracting And Administration Should Ensure Established Policies For All Capital Construction Bid Requirements Are Followed	N/A	0	Resolved during FY 01.
FY 99	99-FAC-12	The Finance And Administration Cabinet Should Provide Sufficient Supporting Documentation For Capital Construction Expenditure Transactions	N/A	0	Resolved during FY 01.
FY 99	99-FAC-14	The Division Of Contracting And Administration Should Maintain Timely Affidavits Of Completion	N/A	0	Resolved during FY 01.
FY 99	99-FAC-16	The Division Of Contracting And Administration Should Implement Procedures For All Applicable Sections Of The Kentucky Revised Statutes	N/A	0	Resolved during FY 01.
FY 99	99-FAC-18	The Division Of Contracting And Administration Should Improve Policies Concerning Insurance Coverage For Construction Contracts	N/A	0	Resolved during FY 01.

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 00	00-CHS-17	The Division Of Substance Abuse Should Conduct Peer Reviews As Required By Federal Regulations	93.959	0	Resolved during FY 01.
FY 00	00-CHS-20	The Cabinet For Health Services Should Improve Controls Over Providers	93.778	0	Resolved during FY 01.
FY 00	00-CHS-21	The Department For Medicaid Services Should Comply With The Interagency Agreement With The Office Of Inspector General	93.778	0	Resolved during FY 01.
FY 99	99-CHS/CDP-27	Custom Data Processing Inc. Should Require Formal Requests For All Program Changes	N/A	0	Resolved during FY 01.
FY 98	98-CHS/CDP-1	Custom Data Processing, Inc., Should Improve Logical Access Security Procedures For The Cabinet For Health Services System Applications	N/A	0	Resolved during FY 01.
FY 98	98-KSFB-8	General Ledger Accounts Should Be Analyzed And Reconciled To Underlying And Supporting Records On A Timely Basis	N/A	0	Resolved during FY 01.
FY 98	98-MA-36	The Department Of Military Affairs Should Strengthen Procedures For Monitoring Subrecipients	83.544	0	This finding relates to the material misrepresentation of the summary schedule of prior audit findings for FY 97 and is considered resolved. However, the initial finding and questioned costs are not resolved. See 01-MIL1-46.
FY 00	99-TC-38	The Division Of Right Of Way Should File All Real Property Deeds In The Project Parcel Files Timely	20.205	0	Resolved during FY 01.

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 00	00-CWD-8	The Division Of Unemployment Insurance Should Perform Regular Cash Reconciliations To Safeguard Assets	N/A	0	Resolved during FY 01.
FY 00	00-CWD-9	The Division of Unemployment Insurance Should Strengthen Controls Over Cash	N/A	0	Resolved during FY 01.
FY 00	00-CWD-24	The Division Of Unemployment Insurance Should Use Valid And Accurate Supporting Documentation For Reports ETA 191 And ETA 2112	17.225	0	Resolved during FY 01.
FY 99	99-CWD-28	The Division Of Unemployment Insurance Should Perform Regular Cash Reconciliations To Safeguard Assets	N/A	0	Resolved during FY 01.
FY 99	99-CWD-29	The Division Of Unemployment Insurance Should Strengthen Controls Over Cash	N/A	0	Resolved during FY 01.
FY 99	99-CWD-41	The Division Of Unemployment Insurance Should Ensure Supporting Documentation Used In Preparation Of Federal Reports Is Accurate	17.225	0	Resolved during FY 01.
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 00	00-CFC-12	The Cabinet For Families And Children Should Impose Sanctions On Subrecipients Who Fail To Meet Audit Requirements Set Forth By OMB Circular A-133	93.558 93.563 93.575 93.596	0	The agency has made progress toward complying with audit recommendations; however, exceptions were still noted. See 01-CFC4-38.
FY 00	00-CFC-16	The Cabinet For Families And Children Should Establish And Enforce Medical Support Obligations For Custodial Parents	93.563	0	Audit once again found that proper enforcement and establishment of medical support was not obtained. See 01-CFC7-41.

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 98	98-CFC-27	The Cabinet For Families And Children Should Maintain Records To Support Payments To Participants In The Kentucky Works Program	93.558	\$0	FY 01 testing revealed missing case files and documentation. CFC has made significant improvement, but weaknesses still exist. See 01-CFC2-36.
FY 97				777	
FY 01				(777)	
Total Questioned Costs				<u>\$0</u>	
FY 98	98-CFC-31	The Division Of Child Care Should Consistently Follow Logical Security Procedures For The Kentucky Child Care Management System	N/A	0	While improvements were made in this area during FY 00, some issues were not resolved. See 01-CFC6-40.
FY 00	00-FAC-6	The Office Of Financial Management Should Improve Control Procedures Over Modifications To System Programs	N/A	0	See 01-FAC3-4.
FY 99	99-FAC-13	The Finance And Administration Cabinet Should Implement Policies And Procedures Relating To Small Or Small Minority Business Set-Aside Laws	N/A	0	The disparity study has not been completed. See 01-FAC7-8.
FY 99	99-GOT-22	The Governor’s Office For Technology Should Restrict Programmer Access To Production Libraries	N/A	0	See 01-GOT1-9.
FY 00	00-CHS-18	The Department For Medicaid Services Should Improve Claims Processing, Including The Dispute-Resolution Process With Drug Rebate Manufacturers	93.778	0	Drug Rebate resolution process still needs improvement. See 01-CHS9-42.
FY 00	00-CHS-19	The Division Of Substance Abuse Should Establish Procedures To Monitor Progress Reports	93.959	0	Improvements needed in timely reporting progress of federal program. See 01-CHS11-44.

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 00	00-CHS-22	The Cabinet For Health Services Should Develop Procedures To Ensure Vendors Providing Services To Federal Programs Are Not Debarred Or Suspended By The Federal Government	ALL	0	Plans in place to implement in FY 03 upon FAC policy approval. See 01-CHS12-45.
FY 99	99-CHS-36	The Department For Medicaid Services Should Improve The Controls Over Drug Rebate Billings, Collections, And Recording	N/A	0	The unresolved issues of this finding were made part of 00-CHS-18.
FY 97	97-CHS-47	The Finance And Administration Cabinet And The Cabinet For Health Services Should Develop Procedures To Ensure Vendors Providing Services To Federal Programs Are Not Debarred Or Suspended By The Federal Government	N/A	0	The agency will implement the policy set forth by FAC upon final approval. See 00-CHS-22.
FY 97	97-CHS-49	The Department For Public Health Should Develop A Complete Information System Security Policy	N/A	0	There was no formal system access request policy in place. No violation or attempted unauthorized system access reports were received from CDP for review.
FY 97	97-Military Affairs-50	The Department Of Military Affairs Should Strengthen Procedures For Monitoring Subrecipients	83.544	\$62,500	Questioned costs were not resolved in FY 01. See 01-MIL1-46.
FY 00				(34,747)	
Total Questioned Costs				<u>\$27,753</u>	

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 98	98-PERS-9	The Personnel Cabinet Should Implement Adequate Logical Access Security For The Unified Personnel And Payroll System	N/A	0	Although the agency took certain steps to control programmer access to production JCL and data, the steps taken were inadequate. However, they have now hired a full-time security employee to deal with this issue and intend to remedy the weakness.
FY 00	00-CWD-23	The Department For Training And ReEmployment Should Comply With JTPA Regulations And OMB Circular A-133 Regarding Resolution Of Subrecipient Audit Findings	17.246 17.250	0	See 01-CWD13-56 and 01-CWD14-57.
FY 00	00-CWD-25	The Department For Training And ReEmployment Should Complete The Process Of Reviewing Subrecipient Invoices And Updating MARS To Accurately Reflect Actual WIA Expenditures	17.255	0	See 01-CWD8-51.
FY 99	99-CWD-40	The Department Of Employment Services Should Implement Controls To Ensure All Applicable Regulations And Program Policies Are Followed In Their Administration Of Federal Programs	17.246	\$ 613,950	The Department of Employment Services is contesting the final determination ruling of the U.S. Department of Labor Grant Officer before an Administrative Law Judge.

(3) Corrective action taken is significantly different from corrective action previously reported:

No findings for this section.

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(4) Audit finding is no longer valid or does not warrant further action:</i>					
FY 00	00-FAC-5	The Finance And Administration Cabinet Should Establish Procedures For Performing A Statewide Physical Inventory And Implement Controls For Proper Accounting And Reporting Of Fixed Assets	N/A	0	An inventory count was performed in FY 01 and has become an annual requirement.
FY 99	99-FAC-17	The Finance And Administration Cabinet Should Provide Clear Language Regarding Enterprise Zones And Use Tax Exemptions Where Applicable	N/A	0	Testing did not include identification of geographical boundaries because it is no longer material to the audit.
FY 96	N/A	The Department For Medicaid Services Should Improve Internal Controls Relating To The Alternative Intermediate Care/Mental Retardation Waiver	N/A	\$120,760	The agency implemented the corrective action plan. The questioned cost has not been resolved. However, the amount of questioned cost is immaterial to the Medicaid program and is not being pursued by the federal government.

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Material Weaknesses/Noncompliances</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 00	00-KST-10	Treasury Should Improve Procedures For The Reconciliation Process And Maintaining Supporting Documentation	N/A	0	Resolved during FY 01.
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 00	00-CWD-11	The Division Of Unemployment Insurance Should Implement The Corrective Action Plan To Assure The Closing Package Schedule For Accounts Receivable Is Correct	N/A	0	See 01-CWD4-33 and 01-CWD5-34.
FY 99	99-CWD-30	The Division of Unemployment Insurance Should Ensure Computer Accounting Systems Are Operating Effectively And Amounts Reported From Those Systems Can Be Supported	N/A	0	See 01-CWD4-33 and 01-CWD5-34.
FY 99	99-CWD-44	The Office Of Training And ReEmployment Should Comply With Job Training Partnership Act Regulations And OMB Circular A-133 Regarding Resolution Of Subrecipient Audit Findings	17.246 17.250	0	See 01-CWD13-56 and 01-CWD14-57.
<i>(3) Corrective action taken is significantly different from corrective action previously reported:</i>					
No findings for this section.					
<i>(4) Audit finding is no longer valid or does not warrant further action:</i>					
FY 99	99-CWD-46	The Kentucky Office Of School To Work Should Comply With School To Work And OMB Circular A-133 Subrecipient Monitoring Requirements	84.278	0	Funds for this grant have been fully expended.

APPENDICES

**COMMONWEALTH OF KENTUCKY
APPENDIX 1
FOR THE YEAR ENDED JUNE 30, 2001**

List Of Agencies Audited As Part Of The Statewide Single Audit Of The Commonwealth

The list includes agencies receiving only financial statement audits used for preparing the Commonwealth's CAFR. CPA reports are available upon request to the respective audited agency.

AGENCIES AUDITED BY CERTIFIED PUBLIC ACCOUNTING FIRMS AND INCLUDED IN SSWAK:

Kentucky Access
Bluegrass State Skills Corporation
Kentucky Center for the Arts Corporation
Kentucky Economic Development Finance Authority
Eastern Kentucky Exposition Center Corporation
Kentucky Educational Savings Plan Trust
Kentucky Educational Television Authority
Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation
Kentucky Horse Park
Kentucky Housing Corporation
Kentucky Infrastructure Authority
Judicial Form Retirement System
Kentucky Local Correctional Facilities Construction Authority
Kentucky Lottery Corporation
Office of the Petroleum Storage Tank Environmental Assurance Fund
Council on Postsecondary Education
Kentucky Retirement Systems
Kentucky State Fair Board
Kentucky Teachers' Retirement Systems
Transportation Cabinet (Financial Statements Only)
Turnpike Authority of Kentucky
Kentucky Worker's Compensation Funding Commission
Kentucky Worker's Compensation Special Fund, Coal Workers' Pneumoconiosis Fund
(functions of the Labor Cabinet), and Uninsured Employers' Fund (function of the
Office of the Attorney General)

**COMMONWEALTH OF KENTUCKY
APPENDIX 1
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

List Of Agencies Audited As Part Of The Statewide Single Audit Of The Commonwealth
(Continued)

**AGENCIES AUDITED BY CERTIFIED PUBLIC ACCOUNTING FIRMS AND
NOT INCLUDED IN SSWAK, EXCEPT FOR EXPENDITURE AMOUNTS IN
THE OPINION LETTER:**

Eastern Kentucky University
Kentucky Community Technical College System
Kentucky State University
Morehead State University
Murray State University
Northern Kentucky University
University of Kentucky
University of Louisville
Western Kentucky University

AGENCIES AUDITED BY THE AUDITOR OF PUBLIC ACCOUNTS:

Department of Agriculture
Department of Education
Cabinet for Families and Children
Finance and Administration Cabinet
Department of Fish and Wildlife Resources
Governor's Office for Technology
Cabinet for Health Services
Personnel Cabinet – Risk Management Funds
Kentucky Revenue Cabinet
Transportation Cabinet (Federal Awards Only)
Office of the Kentucky State Treasurer - Cash Functions
Cabinet for Workforce Development

OTHER REPORTS USED BY THE AUDITOR OF PUBLIC ACCOUNTS:

Custom Data Processing, Inc. SAS 70 Audit Report
eFunds Corporation (eFunds Corporation handles the electronic benefit transfers for the
food stamp program (CFDA 10.551) administered by CFC.)
Governor's Office For Technology SAS 70 Audit Report
Unisys SAS 70 Audit Report

**COMMONWEALTH OF KENTUCKY
APPENDIX 2
FOR THE YEAR ENDED JUNE 30, 2001**

List Of State Agency Contacts

The following is a list of individuals by state agencies to contact regarding findings in the Schedule of Findings and Questioned Costs or the Summary Schedule of Prior Audit Findings.

Agency	Contact
Cabinet for Families and Children (CFC)	Kelli Hill, Manager Division of Financial Management Cabinet for Families and Children 275 East Main Street 4C-C Frankfort, KY 40601 Phone (502) 564-2250 ext. 4336
Finance and Administration Cabinet (FAC)	Stuart Weatherford, Director Division of Statewide Accounting Services Finance and Administration Cabinet Capitol Annex, Room 484 702 Capitol Avenue Frankfort, KY 40601 Phone (502) 564-7750
	Scott Boling, Manager Administrative Services Branch Division of Contracting and Administration Finance and Administration Cabinet 702 Capitol Avenue, Room 158 Frankfort, KY 40601 Phone (502) 564-3050
	Don Speer, Commissioner Department of Administration Finance and Administration Cabinet 702 Capitol Avenue, Room 362 Frankfort, KY 40601 Phone (502) 564-2317

**COMMONWEALTH OF KENTUCKY
APPENDIX 2
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

List Of State Agency Contacts (Continued)

Agency	Contact
Finance and Administration Cabinet (Continued) (FAC)	Gordon Mullis, Executive Director Office of Financial Management Finance and Administration Cabinet Capitol Annex, Room 261 702 Capitol Avenue Frankfort, KY 40601 Phone (502) 564-2924
Governor's Office for Technology (GOT)	Steve Dooley, Executive Director Office of Administrative Services Governor's Office for Technology 1025 Capital Center Drive, Suite 101 Frankfort, KY 40601 Phone (502) 564-7777
Cabinet for Health Services (CHS)	Miles Murphy, Staff Assistant Office of Program Support Cabinet for Health Services 275 East Main Street Frankfort, KY 40601 Phone (502) 564-8890
Labor Cabinet	Robert L. Whittaker, Director Division of Workers' Compensation Funds, Kentucky Labor Cabinet 1047 U.S. Highway 127 South, Suite 4 Frankfort, KY 40601-4381 Phone (502) 564-3070 ext. 391
Department of Military Affairs (MA) (MIL)	Cash Centers, Manager Operations and Recovery Branch Division of Emergency Management Department of Military Affairs 100 Minuteman Parkway, Building 100 Frankfort, KY 40601 Phone (502) 607-1348

**COMMONWEALTH OF KENTUCKY
APPENDIX 2
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

List Of State Agency Contacts (Continued)

Agency	Contact
Personnel Cabinet (PERS)	Herb Sheeting, Commissioner Department of Personnel Administration Personnel Cabinet 200 Fair Oaks Lane Frankfort, KY 40601 Phone (502) 564-2428
Council on Postsecondary Education (CPE)	Diann Donaldson Associate-Administrative Services Council on Postsecondary Education 1024 Capital Center Drive, Suite 320 Frankfort, KY 40601 Phone (502) 573-1555
Revenue Cabinet (REV)	Annie Hill-Pointer, Internal Auditor Office of the Secretary Kentucky Revenue Cabinet 200 Fair Oaks Lane Frankfort, KY 40601 Phone – (502) 564-1553
Kentucky State Fair Board (KSFB)	Ron Duvall, Director Administrative Services Kentucky State Fair Board PO Box 37130 Louisville, KY 40233 Phone (502) 367-5252
Transportation Cabinet (TC)	Taylor Manley, Commissioner Department of Fiscal Management Transportation Cabinet State Office Building, 10th Floor Frankfort, KY 40601 Phone (502) 564-4786

**COMMONWEALTH OF KENTUCKY
APPENDIX 2
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

List Of State Agency Contacts (Continued)

Agency	Contact
Office of the Kentucky State Treasurer (KST)	Dr. Eugene Harrell, Director Disbursements Office of the Kentucky State Treasurer Capitol Annex, Room 183 702 Capitol Avenue Frankfort, KY 40601 Phone (502) 564-4722
Cabinet of Workforce Development (CWD)	Tommy Goins, Branch Manager Division of Fiscal Services Cabinet of Workforce Development 500 Mero Street 9th Floor Frankfort, KY 40601 Phone (502) 564-3200